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*Erasmus*

# **Explaining low tax compliancy by MSMEs actors in Indonesia: with reference to psychological factors**

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## **List of Acronym**

APBN	<i>Anggaran Pendapatan dan Belanja Negara</i>
AR	Account Representative
ASEAN	Association of Southeast Asian Nations
DGT	Directorate General of Tax
DPR	<i>Dewan Perwakilan Rakyat</i>
GDP	Gross Domestic Product
IDR	Indonesian Rupiah
LAKIN	<i>Laporan Kinerja</i>
MoF	Ministry of Finance
MSME	Micro Small Medium Enterprise
NPWP	<i>Nomor Pokok Wajib Pajak</i>
OECD	Organisation for Economic Co-operation and Development
PNBP	<i>Penerimaan Negara Bukan Pajak</i>
PP	<i>Peraturan Pemerintah</i>
PPh	<i>Pajak Penghasilan</i>
PPN	<i>Pajak Pertambahan Nilai</i>
RI	<i>Republik Indonesia</i>
SKPKB	<i>Surat Ketetapan Pajak Kurang Bayar</i>
SKPN	<i>Surat Ketetapan Pajak Nihil</i>
SKPLB	<i>Surat Ketetapan Pajak Lebih Bayar</i>
SPT	<i>Surat Pemberi Tabuan</i>
TIN	Tax Identification Number
UMKM	Usaha Mikro Kecil dan Menengah
UPE	Unplanned Evasion

## Abstract

Tax compliance is an important issue that must be taken seriously by the government. As a country where 80% of the budget comes from tax revenues, the low Tax-to-GDP ratio is a nightmare for Indonesia. Based on the OECD survey, in 2019 Indonesia was only able to achieve a ratio of 11.6%, which statistically this figure is still far below the standard of OECD member countries which is at 34.4%. Even for fellow ASEAN member countries (which are considered to have almost similar economic conditions and strength), Indonesia is still below it (around 12.8% in the same year). This situation is clearly not very encouraging, because this figure gives us a real picture of the low level of tax compliance of Indonesian taxpayers. Based on this phenomenon, this study tries to explore the finding both in surveys and interviews and tries to capture the actual situation in the field where Indonesian people who work as macro, small and medium business actors have to deal with tax obligations. This study does not use traditional economic models to explain why tax compliance of Indonesian taxpayers is still low, but rather uses psychological factors to provide a new perspective and novelty to several studies that also discuss tax compliance in Indonesia.

*Kepatuhan perpajakan menjadi sebuah isu penting yang harus ditangani oleh pemerintah secara serius. Sebagai sebuah negara dimana anggaran pendapatannya 80% diperoleh oleh penerimaan pajak, jelas rendahnya tingkat rasio Tax-to-GDP merupakan sebuah mimpi buruk bagi Indonesia. Berdasarkan survey yang dilakukan oleh OECD, pada tahun 2019 tercatat Indonesia hanya mampu mencapai rasio sebesar 11.6%, yang secara statistik angka ini masih jauh dibawah standar negara-negara anggota OECD yang berada pada angka 34.4%. Bahkan kepada sesama negara anggota ASEAN (yang dianggap memiliki keadaan dan kekuatan ekonomi yang relatif mirip), Indonesia masih berada dibawahnya (berkisar 12.8% pada tahun yang sama). Keadaan ini jelas sangat tidak menggembirakan, karena angka ini sejatinya memberikan gambaran nyata kepada kita atas rendahnya tingkat kepatuhan perpajakan wajib pajak Indonesia. Berdasarkan fenomena tersebut, penelitian ini mencoba untuk menjelajahi cerita-cerita dan juga mencoba menangkap keadaan yang sebenarnya terjadi dilapangan dimana masyarakat Indonesia yang bekerja sebagai pelaku usaha makro, kecil, dan menengah (UMKM) harus berhadapan dengan kewajiban perpajakan. Penelitian ini tidak menggunakan model ekonomi tradisional untuk menjelaskan mengapa kepatuhan perpajakan wajib pajak Indonesia masih rendah, namun lebih menggunakan faktor psikologi untuk memberikan sebuah pandangan baru dan kebaruan dalam beberapa penelitian yang juga membahas tentang kepatuhan perpajakan di Indonesia.*

## Relevance to Development Study

By combining the data released by the Directorate General of 'Taxes' performance report and the OECD Survey regarding the Tax-to-GDP ratio, it can be concluded that tax compliance in Indonesia is low. The low tax compliance will have a direct effect on state revenue, where state revenue is an important component for the government in carrying out its functions.

In line with the government's efforts to reform the existing tax system, this research is expected to be able to provide input to stakeholders so that it becomes a valuable input in the process of creating a fiscal policy that can increase tax compliance and revenue as well as provide a stimulus for economic progress and development of Indonesia.

## Keywords

Tax, Tax Compliance, MSME, Indonesia, Psychology, Taxpayer, Behaviour



# Chapter 1 – Introduction

*“Research on tax compliance convincingly argues that successful tax collection is not only the exercise of power, but reliant on a mixture of ‘carrot’ and ‘stick’ approaches.*

*(Koessler et al 2019 p.1)*

## 1.1 Background

Over the years, economists have paid great attention to studies about individual tax evasion. However, “despite these efforts, our understanding of what is the real reasons behind individual tax compliance is still very limited” (J. Alm, 1992, p.21). Until now, the Government of Indonesia through the Directorate General of Tax (DGT), is still struggling to fight the disadvantageous effect of the informal/shadow economy in Indonesia. Shadow economy based on V. Braithwate et al (2003) in Kirchler (2007) is the type of economy, by referring to components of the economy identified by OPEC, as “non-official economic activities, namely underground production (activities that are legal and productive but concealed from public authorities), illegal production, informal sector production and production of households for their own final use” (Kirchler, 2007, p.13).

In research conducted by Muhammad Dyal (1998), where he stated that the emergence of the informal sector of the economy due to rapid economic growth in the two decades of national development has had both positive and negative impacts. The positive impact is that this sector can absorb a sizeable workforce and stimulate the economy stably and independently. While the negative impact, they<sup>1</sup> have a very minimal contribution to state revenue (taxes), especially taxes collected by the central government, such as income tax (PPh) and value-added tax (PPN). The reason is that they have different characteristics from economic activities that have a basis in the formal economy, plus the existing tax laws are too focused on the ‘big player’ of the formal sector. This situation makes the informal sector too ‘protected’ with various rules that make them escape from taxes and finally become increasingly ‘hard to tax’ (Dyal, 1998). A similar statement was also made by the Minister of Finance of the Republic of Indonesia, Sri Mulyani Indrawati<sup>2</sup>, in a joint meeting with Commission XI of the House of Representatives of the Republic of Indonesia (DPR RI) in 2021. As reported by CNBC Indonesia, Mulyani (2021) stated that the current Tax - to-GDP ratio owned by Indonesia is low due to the high level of informality. Further, she explained that there are still many informal economic actors who have not entered the system, coupled with tax incentives/facilities and the level of compliance is still relatively low (Mulyani, 2021). This is an irony, considering Indonesia is one country that makes taxes as the main component of its revenue.

In contrast to individual taxpayers who work as MSME entrepreneurs (or non-official economic activities in general), individual taxpayers with the status of employees have an office treasurer who will always perform tax calculations and make tax deductions every month

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<sup>1</sup> The workers or business actors who are active in the informal economy sector

<sup>2</sup> Minister of Finance of The Republic of Indonesia sin 2005 to 2010, and sin 2016 to now (2022)

based on applicable laws (Withholding system). They do not need to be frightened of making the wrong use of the applicable tax rates because the treasurer will do it automatically. The remaining obligation they need to do themselves is to file tax returns. This obligation is relatively easy to do because it is simply to report once a year, and the form used is also much simpler when compared to individual taxpayers who work as MSME entrepreneurs. Therefore, for taxpayers in this sector, the level of compliance is not so worrying.

Non-compliance with taxation in informal economic activities is not something the Directorate General of Taxes can easily handle. For informal economy actors who still need to register, their form of non-compliance is shown by not registering themselves with the tax office. This is due to their ability to hide from government radar so that they may not be registered in any government system, and even in some cases, the government itself is unaware of its existence or emergence (Kirchler 2007, p.15). For those who have registered, Kirchler (2007) in Widiyanto (2015) stated that a common form of non-compliance is the failure of taxpayers to fulfill their tax obligations, such as:

- 1) failure to fill out the Annual SPT<sup>3</sup> (Tax Return) under the tax provisions,
- 2) their low level of awareness to report their annual tax return,
- 3) Intentionally (or not) to report their income under the actual conditions/under report (to avoid taxes) (Widiyanto, 2015, p.2).

In Indonesia, despite the many studies that specifically examine the level of tax compliance, not many discuss or use psychological factors in their research. For example, research conducted by Widiyanto (2015) uses demographic factors in finding out the reasons behind the non-compliance of individual taxpayers. Meanwhile, in the research conducted by Nugroho (2020) which specifically examined the Unplanned Evasion (UPE) carried out by MSME actors using Benford's law in detecting non-compliance that occurred by also focusing on gender and age. Then there is also Falanni (2015) who discusses tax compliance with a focus on corporate taxpayers, where he uses a Likert scale to measure perceptions of taxation. And the last one is Nuryanah (2021) who in her research specifically examines tax compliance by linking it with tax administration reforms carried out by the government. Based on this, in this research, I try to bring novelty to the discussion that specifically examines tax compliance by specifically referencing it with psychological factors.

## 1.2 Problem Statement

Taxes are an essential component of Indonesia's revenue. Based on the performance report released by the Ministry of Finance of the Republic of Indonesia, it is stated that from 2016 to 2020, taxes have contributed at least 80% of the total state revenue. While the rest is filled by non-tax state revenues (PNBP<sup>4</sup>), which consist of revenues from natural resource management (trades), public services, state property, grants, etc. (LAKIN<sup>5</sup> Kemenkeu<sup>6</sup> 2016-2020).

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<sup>3</sup> Surat Pemberi Tahu, Formal language in Bahasa Indonesia for Tax Return

<sup>4</sup> Penerimaan Negara Bukan Pajak, an official term used by the Indonesian government to refer to all non-tax state revenues

<sup>5</sup> LAKIN means Laporan Kinerja or Performance Report

<sup>6</sup> Kemenkeu means Kementerian Keuangan or Ministry of Finance

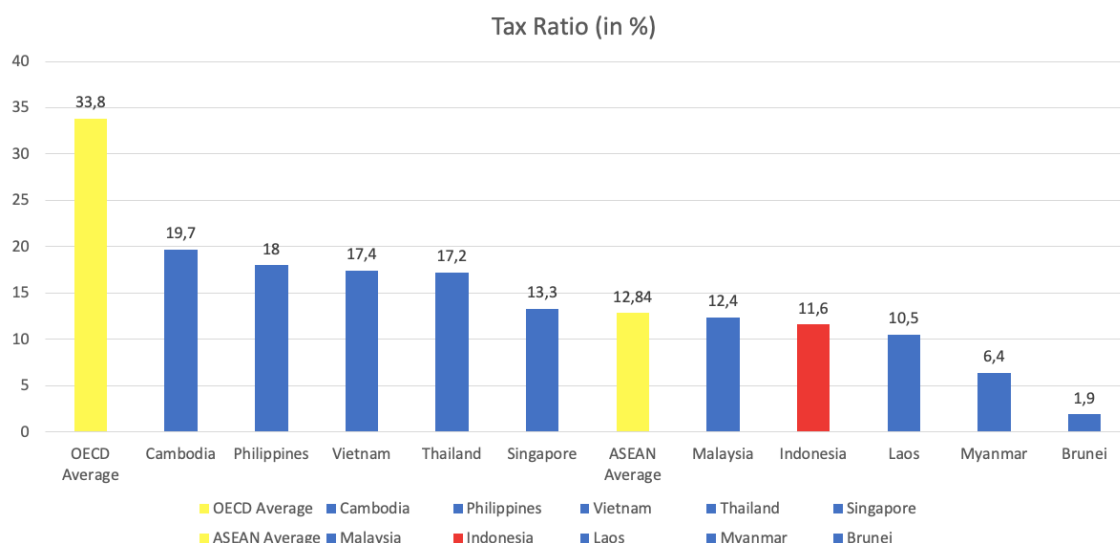
**Table 1. Tax Revenue compared to Domestic Revenue of Indonesia (In Trillion)**

	2016	2017	2018	2019	2020
Domestic Revenue	1.822,50	1.748,90	1.894,70	2.165,10	2.233,20
Tax Revenue	1.546,70	1.498,90	1.618,10	1.786,40	1.865,70
Percentage	84,87%	85,71%	85,40%	82,51%	83,54%

Source: Ministry of Finance of The Republic of Indonesia (2022) developed by author

Referring to the large percentage given by taxes to the structure of state revenues, it can be said that Indonesia is a country that has a high dependence on the fiscal sector. However, the exceptionally high dependence of the Indonesian state budget on tax revenues is not accompanied by a good Tax-to-GDP<sup>7</sup> ratio either. The Indonesian government is forced to accept the harsh reality, which shows that the performance of the tax ratio of Indonesia was still far from the average OECD countries. In the latest survey conducted by the OECD in 2021, Indonesia was only able to establish a percentage of 11.6% in 2019, which is significantly lower than the average standard of the OECD Countries of 34.4 %. Even among ASEAN countries (where in terms of GDP, they do not have a significant difference), Indonesia is still below the average of them (about 12.8% in 2019). It only manages to be above Laos (10.5% in 2019), Myanmar (6.4% in 2019), and Brunei (1.9% in 2019) (OECD, 2022).

**Figure 1. Tax-to-GDP ratio of ASEAN Countries**



Source: OECD 2021, developed by the author

According to the Expenditure & Income Book issued by the Center for Budgetary Studies of Indonesia, there are several factors that affect the tax-to-GDP ratio, which is:

- a. Macro factors, including tax rates, per capita income levels and the level of optimizing good governance.

<sup>7</sup> A ratio that portrays the performance of tax revenue for one year period in relevance with GDP. It is calculated by dividing Tax revenue by GDP

- b. Micro factors, including the level of taxpayer compliance, commitment and coordination between state institutions and the common perception between taxpayers and tax officials.

Based on that, it can be concluded that non-compliance of taxation is one of the problems causing the low tax-to-GDP ratio in Indonesia.

### ***1.2.1 Why MSMEs?***

According to the BKPM<sup>8</sup> (Investment Coordination Agency) website, which is part of the Ministry of Investment, MSME business actors have a vital role in the Indonesian economy. The role is:

- Apart from its informality, MSMEs themselves greatly contribute to Indonesia's gross domestic product by contributing 61.97% or equivalent to 8,500 trillion Rupiah in 2020.
- MSMEs have absorbed 97% of Indonesian entering working age (BKPM, no date, accessed at: 19 Oct 2022). With such a large number, more attention is needed from the government for this sector, especially related to taxation.

The Tax-to-GDP ratio figure described above illustrates how this sector needs to be appropriately managed. The high level of informality coupled with the government's self-assessment system explains that it will take much work for the government to improve its tax compliance. In this study, the authors will try to analyze the existing tax policies, the intrinsic motivations of MSME sector taxpayers, the level of complexity of tax rules, and link them in several psychological theories in the hope of providing an analysis that can be used in creating a psychology-based interventions that can increase MSMEs actors' voluntary compliance.

## **1.3 Significance of the Study**

This research provides significance in three ways, namely:

1. Empirical research that specifically explores the phenomenon of low tax compliance among individual taxpayers (not limited to an individual taxpayer non-employee) regarding psychological factors is not widely carried out in Indonesia, so that this research can bring novelty to existing research.
2. The findings of this study can provide input for stakeholders to draft a law related to efforts to increase tax compliance of individual taxpayers.
3. The results of this study can be used as additional knowledge for employees of the DGT to create an excellent working climate among fellow employees or with taxpayers.

## **1.4 Research Objectives and Questions**

### ***1.4.1 Objective***

The purpose of this study is to examine the role of psychology on the level of compliance of individual taxpayers by examining the factors of tax morale, fiscal contracts intertwined between taxpayers and tax officers, the complexity of the tax laws, and the relationship be-

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<sup>8</sup> Badan Koordinasi Penanaman Modal

tween taxpayers and tax officers. The findings of this study are expected to provide valuable input to policymakers at the Indonesian Directorate General of Taxes in designing a policy that is expected to be able to increase Indonesia's tax ratio in the not-too-distant future.

#### ***1.4.2 Question and Sub-questions***

This research attempt to answer the objectives of this study by investigating people's current attitude towards tax compliance by tracing it through the connection of individual tax compliance, specifically individuals who carry out business activities in the MSME sector in Indonesia, to several psychological such as tax moral, fiscal contracts, the complexity of the tax law, and the relationship between taxpayers and tax officers. Therefore, the research question I will use is:

*“By looking at it from a psychological point of view, how is the current attitude of an individual taxpayer who owns micro, small and medium enterprises towards the tax system in Indonesia?”*

Then, this study also tries to answer some additional questions related to the main question, namely:

- a. Can one (or more) psychological factors be the only factor affecting tax compliance?
- b. What psychological factors should the government prioritize if they want to formulate a tax policy?

### **1.5 Research Methodology**

This study is an explanatory study that tries to explain the phenomenon of the low level of tax compliance of individual (non)taxpayers in Indonesia by relating it to several psychological factors. To answer the research question, the author used a combination of two types of data: primary and secondary data. Primary data was taken using the survey as well as semi-structured interviews. In contrast, secondary data use published data by the Ministry of Finance, Directorate General of Taxes, and other sources relevant to the research topic.

#### ***1.5.1 Primary Data***

The primary consideration I used to make surveys one of the data collection methods was that surveys could capture data unavailable in databases or other literature. In addition, the survey can reach many experienced actors and people (compared to interviews) (Panke, 2018, p.221). This survey used a Likert scale as well as open-ended questions. Dissemination of the survey utilizes electronic messaging technology. This is done to increase the efficiency of time and costs I must incur during the data collection process. I asked several colleagues from several WhatsApp<sup>9</sup> groups to distribute my research survey without mentioning my identity as a tax officer<sup>10</sup>. The preparation of questions also uses a website called Kobo Toolbox<sup>11</sup>.

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<sup>9</sup> Instant messaging application for computer and phone

<sup>10</sup> The reason by this action will be explained on positionality section.

<sup>11</sup> Internet based tool for data collection

The other method I used to collect primary data was a semi-structured interview. For the semi-structured interview, I interviewed several active entrepreneurs in the MSME sector. My consideration for using semi-structured interviews was to obtain novel information that I could not get from databases or reports issued by related organizations. King (1994), Holstein and Gubrium (2004), King and Horrocks (2010) in Panke (2018) explained that the interview included background information, actor perception, and information on independent and dependent variables, as well as steps in causal likelihood (Panke, 2018, p.215). This can also cover the shortcomings of the survey method, which can only present data with specific and structured answers.

Furthermore, I specifically divided the two interview participants into two categories for the semi-structured interview. The first is the participants who already have an NPWP<sup>12</sup>, and the second is those who do not yet have an NPWP. I consider this the best way to capture the complete picture of the attitude behind a person's actions to obey or disobey the tax system. In addition, I have also selected several participants from various domiciles that are different from one another. This is done to increase the level of representativeness of the interview participants.

### ***1.5.2 Secondary Data***

For secondary data, I used several previous studies as a writing context related to the current taxation state in Indonesia. I also used some official data released by the government in the past few years. These documents are also intended to describe a relevant condition for the low tax compliance that occurred in Indonesia for several years before this research was conducted. Some of the documents that I used were as follows:

1. Directorate General of Taxes Performance Report 2015 to 2020
2. Additional rules/decrees explicitly issued by the Ministry of Finance and the Director General of Taxes regulates in detail several tax policies.
3. Taxpayer satisfaction survey report on services of the Directorate General of Taxes from 2016 to 2020
4. Official publications on government websites outside the ministry of finance that are related to the topic of this research

While collecting and processing data, I also used some academic literature, reports, articles, news, and several other documents that I deemed relevant to this research topic.

## **1.6 Population**

The population used in this study are all individual taxpayers (and non-taxpayer) who work as MSME actors, self-employed, and employees in Indonesia. The consideration underlying the decision to choose the whole country is to reduce the possibility of bias from selecting taxpayers only specified in one region. Experience, government system, ease of doing business, the assistance provided, and several other factors in one region can be very different. By using a population spread throughout Indonesia, these differences can be represented so that comprehensive results are obtained. Furthermore, this study aims to analyze the low level of tax compliance that occurs among people in Indonesia by relating it to several psychological factors. If the author only takes a sample from one region, then the expected representation of this research cannot be realized properly.

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<sup>12</sup> Tax identification Number

This study had a total of 101 survey participants. This amount was obtained after distributing the questionnaire through electronic media such as WhatsApp. For interview participants I chose them directly from the survey participants. The primary filter that forms the basis for selecting taxpayers to participate in the interview process is the willingness to participate in the interview itself. A question that asks the person's willingness to be interviewed has been inserted among several questions, so that I can quickly sort the people who are willing to be interviewed based on their answers. After taking a further approach, out of 56 people who said they were willing to be interviewed. I managed to get as many as 14 people from various domiciles and types of businesses owned to be interviewed.

## **1.7 Scope, Limitation, and Positionality**

### ***1.7.1 Scope***

This study wants to explore the background of tax compliance of individual taxpayers (or non-taxpayer) in Indonesia. This study will focus on finding out the attitude of individual taxpayers towards the taxation system, by referencing it with psychological factors such as tax moral, fiscal contract, complexity, and relationship. Individuals referred to in this study are individuals who have income from business activities (not limited to self-employed and employees), both those who have registered or will register with the tax office and who are domiciled throughout Indonesia. Specifically, the business activities referred to in the research refer to the term MSME under the definition of Law number 20 of 2008.

### ***1.7.2 Limitation***

Because this research is exploratory research that combines two data (primary and secondary), there are some limitations in accessing the data needed during the research process. This research is a master's study with a reasonably short period of time. So, there is a possibility that the data obtained in a short time will result in noise, in which there is a bias. No research can be completely free from bias. Therefore, the best step I can take is to keep the level of bias to a minimum. The strategy that I applied to overcome these problems, as I explained in the previous section, I used two methods in the data collection process. Namely surveys and semi-structured interviews conducted throughout Indonesia. With the increasing number and variety of samples involved, it is hoped that it will provide a comprehensive picture of the topic to be discussed.

For primary data, the data collection activities carried out by using surveys and interviews. Because the sample that I want to target is small and medium-sized entrepreneurs (MSMEs), most of whom do not have good experience in operating technology, the possibility of problems occurring will be significant. Their low level of technology literacy is feared to be an obstacle during the interview or the survey filling process because these two activities will use the internet and several applications such as zoom, Google Forms, and other web-based applications. To suppress this problem so that the impact is minimized, the author tried to get contacts from several entrepreneurs who are members of a group or association with experience in operating technology and internet-based applications. Due to the distribution of the survey conducted through electronic messages, the selection of taxpayers who understand how to use internet-based computer technology is one of the authors' ways to ensure that the forms distributed have appropriately arrived in the hands of the recipients. In addition, the selection of taxpayers who have good literacy on how to use the internet can reduce the possibility of erroneous content in the survey forms that have been distributed. Surveys that are not filled out completely or filled out completely but haphazardly can lead to results that the writer does not desire. The survey is also car-

ried out as efficiently as possible with a duration of about 10 minutes, and the use of language also be adjusted to the language and words that are often encountered in daily conversation. For the interview session, the author selected several willing entrepreneurs to be interviewed, with a note that they would be interviewed online. That way, anyone willing to be interviewed will understand their obligation to provide adequate tools needed during the interview process.

The following possible limitation is that these people will not answer questions at all because taxes are a sensitive issue, or their answers will be fabricated. It could have happened because they do not want to get involved with tax matters at all, and the reason is that they are afraid that their data will be given to the tax office, which will result in them being chased by tax officials. To address this issue, the author provided a consent form and an announcement to the participants stating that their confidentiality would be fully guaranteed. Moreover, all the answers they give during the survey and the interview will be used only for academic purposes and will not be submitted to any party without their consent. They also can answer the questions that are given anonymously so that their comfort will be maintained, and the answers given by them can reflect the actual situation and be free of the possibility of that answers being fabricated. The author's questions were also designed so that the survey participants and interviewees could provide honest and candid answers.

For secondary data, there are several documents that require formal permission to access them. Authors must submit a cover letter signed by the university to the Directorate General of Taxes so then written permission to access the data can be issued. The time required during the permit issuance process and the issuance of the requested data can be lengthy due to the bureaucracy within the DGT, which results in the time required is longer/beyond the author's expectations. To overcome this problem, I retrieved relevant data on the Internet.

### ***1.7.3 Positionality***

While collecting data, I positioned myself as a student, relinquished my status as a tax employee, and acted as professionally as possible. All attributes that indicate my status as a tax officer will be hidden to maintain the convenience of the respondents to fill out surveys and answer interview questions. That way, I can suppress the bias that might arise as much as possible. This step was also taken based on considerations to maintain the quality of the data I got, which was also stated by several researchers who stated that some data would have good quality if it was taken without mentioning the identity of the data taker. For example, Giddens (2009) in Calvey (2017) stated that "Indeed, some of the most valuable data that have been collected by sociologists could never have been gathered if the researcher had first explained the project to each person encountered in the research process" (Calvey, 2017, p.5). Chriss Herrera (2008), in her journal entitled 'In Praise of Undercover Research' in the Canadian Medical Association Journal (CMAJ), mentions that in the medical world, undercover research 'should be seen as one method among several to collect evidence about the nature and quality of routine medical care' (Herrera, 2008).

I also positioned myself as an Insider interviewer, where all the people I interviewed were Indonesian. Since I am also Indonesian, I used Bahasa Indonesia for the entire survey process and for a semi-structured interview. This condition creates a sense of comfort among the survey and interview participants because they do not have to use a foreign language just because I am an international student.



## **1.8 Organization of the Research Paper**

To develop an understanding of the current state of tax compliance of individual taxpayers in Indonesia and to answer the research questions of this research, this research paper will be structured as follows. Chapter one is devoted to discussing the background of this research, the significance of this research, research objectives, research questions, methodology used to answer research questions, scope, and limitations of the research. Chapter two will focus on presenting the conceptual framework, literature review related to taxes, tax morals, fiscal contracts, laws complexity, interactions between tax officials and taxpayers, and tax compliance itself. Chapter three will specifically discuss the contextual background of the low tax compliance in Indonesia, the current tax regulations, and their correlation with concepts that affect tax compliance. Chapter four will discuss the findings from table analysis, surveys, and interviews that will be used to answer research questions. Chapter five will be the final chapter and will focus on providing conclusions.

## Chapter 2 – Conceptual Framework

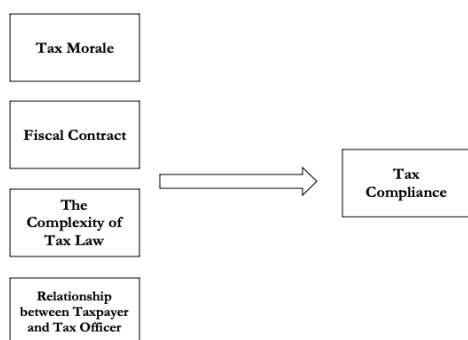
*“The terms ‘psychology’ or ‘psychological’ appear in only 10% of the titles and abstracts of publications.... Clearly, the field (of tax compliance study) is dominated by economics”  
(Kirchler 2007, p.1)*

### 2.1 Introduction

This study aims to bring novelty to several studies focusing on tax compliance that has long existed in Indonesia. Not many of these studies discuss psychological factors or factors other than purely economic factors in analyzing the phenomenon of the low level of tax compliance in Indonesia. Therefore, in this chapter, I will try to use several concepts that several researchers have used before to investigate the low level of tax compliance in Indonesia. According to them, these factors are not economic factors. They prefer to call these factors/concepts psychological factors because some are focused on human behavior. The concepts will be discussed: Tax Morale, Fiscal Contract, Tax Law Complexity (Subjective Knowledge, and Relationship.

The consideration in choosing the psychological factors that I used in this study, apart from the influence of the research conducted by Kirchler (2007), is based on the efforts of this study not to look at the problem of low tax compliance in Indonesia from one side only, either it is from the side of the taxpayer or the side of the tax authority. Like Isaac W Martin et al. (2009), in their book entitled 'The New Fiscal Sociology: Taxation in Comparative and Historical Perspective', they divide the two significant chapters of their book by looking at it from two sides, namely the state side and the taxpayer side. In their book, they try to shed light on all classic questions raised by Schumpeter related to tax compliance by focusing on the social sources of tax systems (the state), the determinant of taxpayer consent (taxpayer), and the social and cultural implications arising from taxation (Martin et al., 2009, p.14). Based on this, this study generally sees taxpayers and the state as a single entity involved in a reciprocal relationship. Tax Morale, Fiscal Contract, Tax Law Complexity, and the relationship between tax officers and taxpayers put both parties involved. The findings obtained from the data analysis process in this study will be valuable input for both parties to resolve the wicked problem that underlies the low tax compliance in Indonesia. In line with what Kirchler (2007) said in the book, this research is also expected to be able to summarize and integrate findings from psychology-based research as well as purely economic-based research. He further added that both are scientifically cutting-edge and practically applicable (Kirchler, 2007, p.2).

**Figure 2. Classification of determinants of tax compliance**



Source: Kirchler 2007, adjusted by author

## 2.2 The Concept of Tax Morale

In a book written by Kirchler (2007), tax morale is a concept that implicitly describes the intrinsic motivation of a taxpayer to comply with existing tax rules (Kirchler, 2007, p.99). He got this understanding from a researcher in 1960 named Schmolders, who defined tax morale as an attitude shown by a group of people or the entire population of taxpayers regarding their obligations in fulfilling tax obligations. He further explained that the tax morale is anchored to citizens' tax mentality and their complete awareness to become citizens, which is based on full acceptance of tax obligations and acknowledgment of the sovereignty of the state (Kirchler, 2007, p.99).

Based on that, tax morale is an intrinsic motivation different from extrinsic motivation. Extrinsic motivation is characterized by "the reason for doing it is something other than an interest in the activity itself" (Hand, 2018, p.6), while intrinsic motivation is characterized by "people engaging[d] in activities freely, being sustained by the experience of interest and enjoyment" (ibid).

Graham and Weiner (1996) in Hands (2018), in a study on motivation, stated that "behavior was driven by the need to satisfy psychological needs" (Hands, 2018, p.29). The same thing is also expressed by Deci (1971) in Frey and Jegen (2001), which states that most significant schools that focus on psychological studies emphasize that motives come from within a person. Which "one is said to be intrinsically motivated to perform an activity when one receives no apparent reward except the activity itself" (Frey & Jegen, 2001, p.133).

This further emphasizes that a person's attitude can be influenced if they feel satisfaction by doing something. For example, a person can be very obedient to the existing tax system and love to pay and submit tax returns correctly because they love the country very much. They felt that they would become a patriotic person (and become satisfied about it) because they had carried out their obligations properly. However, the opposite can happen if someone does not love the country, or someone does not have high trust in the government. They usually do not obey and tend to do tax evasion because they do not enjoy obeying the government.

## 2.3 The Concept of Fiscal Contract

According to the Law of the Republic of Indonesia Number 28 of 2007 concerning the Third Amendment to Law Number 6 of 1983, which regulates general provisions and procedures for taxation, it is stated that tax is a "compulsory contribution to the state owed by an individual or entity that is coercive under the law, by not receiving direct compensation and being used for the state for the greatest prosperity of the people" (Article 1 of Law number 28 of 2007). If we look at the definition, the government clearly states that taxes do not have direct benefits that the people of Indonesia can feel. Because these taxes are collected in one large container called the APBN<sup>13</sup>, the only benefits they can feel are public facilities and government services, which have been fully budgeted in the APBN for the next year. There is no 'reward' facility like Feld (2006) stated in his research, where "in Asian countries, for example, Japan offers to have your picture taken with the emperor if

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<sup>13</sup> Anggaran Pendapatan dan Belanja Negara, Indonesian formal name for state budget

you were found to be honest. The Philippines put your name into a lottery if you were found to be compliant with the VAT. South Korea considers the allowance to airport VIP rooms, certificates, or awards, and discusses the possibilities of free parking in public parking facilities" (Feld, 2006, p.4). Supposedly, a good policy is a pro-people policy. James and Alley (2002) stated that "the primary purpose of taxation is to benefit rather than punish citizens, this would seem to be an appropriate policy" (James & Alley, 2002, p.28).

Feld and Frey (2007) proved that the reciprocal relationship between the government and taxpayers in providing public goods and satisfying services augmented with a sound democratic system where public representation in government functions well influences tax morale. People pay taxes hoping the government will provide services and facilities they can use daily (Bräutigam, 2008). This belief is then firmly held by many people to be able to remain to comply with any regulations that the government applies to them, including taxation. Unlike the previous variable, which relied on intrinsic motivation to comply with a policy, this concept will rely more on the reciprocal relationship between the government. Tax is a psychological contract built by the government with the taxpayer, hoping a reciprocal relationship will arise between the two (Feld & Frey, 2002).

Furthermore, Bräutigam (2008) says that Levi (1988) emphasizes that quasi-consensual taxation involves reciprocity, where people are aware and fully understand that they must pay for the services they expect. These services, he further added, include security services and protection from invading forces or public goods, as well as other social services that they can take advantage of. This mutually beneficial action will make people pay attention to how the government uses the tax money they have deposited. This will affect their legitimacy and 'right' to collect taxes from taxpayers (Bräutigam, 2008, p. 27). Thus, in this factor, I argue that although the government cannot provide direct 'reward' to taxpayers for their loyalty in fulfilling their tax obligations to the state, at least the government can guarantee the existence of reliable public facilities and services in return.

## **2.4 The Concept of Tax Law Complexity (Subjective Knowledge)**

Tax laws are difficult to understand and are of little interest to the ordinary taxpayer (Kirchler, 2007, p.28). This statement can describe most Indonesian people (especially those who work as micro, small, and medium-scale entrepreneurs) if asked for their opinion on taxation. During my eight years of experience as a tax officer, I have often come across similar statements made by taxpayers. This opinion then developed rapidly and became a shared habit, giving rise to the understanding that tax is complicated to understand, and there will be no benefit for them if they know about it. Cullis and Lewis (1997) see this situation as a taxation phenomenon, which is formed from social construction, which later becomes guidelines for behavior (Kirchler, 2007, p.28).

This phenomenon is not an event that is rarely found anywhere in the world. Furnham (2005) stated that young people tend not to care about the existing tax system. On the other hand, according to McKerchar (1995), older people also do not understand the existing tax rules very much. The combination of these two problems then becomes a reason for someone not to seriously update themselves on the tax system. It leads to the condition where "people blame the complexity of the tax law for their feelings of tax incompetence and lose interest in the system" (McKerchar 2001 in Kirchler 2007, p.32). This statement was in line with two researchers, Sakurai and Braithwaite (2003), who surveyed more than 2000 Australian taxpayers. They found that only a tiny percentage of respondents described

themselves as very understanding and competent in the applicable taxation system (Kirchler, 2007, p.32). In comparison, Lewis (1998) in Kirchler (2007) found that some people think tax policy is something that is not important (ibid).

So, are tax regulations really that difficult? Only sometimes. In the past two decades, the Indonesian government has made several changes that have made taxation rules for micro, small and medium entrepreneurs as straightforward as possible. However, the possibility for the public to be confused still exists due to the existence of other tax rules for non-entrepreneurs (employees and companies), regional tax regulations, and several other government systems that involve many legal grounds, making people dazed and reluctant to study them. So, the statement made by Kirchler that “tax laws are not always clear” (Kirchler, 2007, p.5) is accurate.

Slemrod et al. (2001) in Kirchler (2007), also explained that “...in practice there is blurry; sometimes the law itself is unclear, sometimes it is clear but not known to the taxpayer, sometimes the law is clear, but the administration effectively ignores a particular transaction or activity” (Kirchler, 2007, p.5). Considering a large number of existing laws (plus many additional implementing regulations in the form of a regulation by the minister of finance and a regulation by the director general of taxation), it is not surprising that this non-compliance is also the result of the complexity of tax law. The complexity of the existing tax system and the length of bureaucracy in Indonesia was then exploited by several tax evaders to take advantage of this loophole (Even small players, such as MSMEs, can become tax evader by not registering at the tax office). Kirchler (2007) explained that “businesses take advantage of loopholes when new regulations and laws are established in response to aggressive avoidance. Businesses also respond symmetrically to tax changes, moving into the underground economy if taxes increase and out when they decrease” (Kirchler, 2007, p.5).

## **2.5 The Concept Interactions between taxpayers and tax authorities**

What punishment should be given to make tax avoiders comply is still a big question (J. Alm, 1992, p.21). Allingham and Sandmo (1972) in J. Alm (1992) said that “a rational individual is viewed as weighing the expected utility of the benefits from successful tax evasion with the uncertain prospect of detection and punishment, and an individual pays taxes because he or she is afraid of getting caught” (ibid). In line with what was stated by Kastlunger et al. (2012), who researched tax compliance in Italy, also stated that “Assuming that taxpayers behave as rational agents, in the case of tax evasion their decisions to comply depend on the risk of being caught” (Kastlunger, 2013, p. 36). This fear that arises from tax evasion is real and exists in every taxpayer. Kirchler (2007) in Kastlunger (2013) criticizes Becker’s theory of crime (1968) which focuses on the possibility of a taxpayer complying if there is the possibility of being investigated and imposing a fine on them.

Nevertheless, on the other hand, an act of coercion exhibited by the government is only sometimes successful in increasing tax compliance. In a field experiment conducted by Mascagni and Nell (2021) in Rwanda, it was stated that “friendly approach to tax compliance is highly effective compared with deterrence” (Mascagni & Nell, 2021, p.588). Feld et al. (2006) also stated a similar explanation which stated that “deterrence models predict far too little compliance and far too much tax evasion” (Feld et al. 2006, p.2). These two methods are, in some cases, always able to give maximum results depending on the circumstances.

The relationship between tax officers and taxpayers can vary depending on the attitude shown by each party. The tax officer may act as a firm ‘policeman’ with legitimate power capable of punishing citizens who do not comply. Alternatively, vice versa, tax officers can be a super friendly and reliable community protector whenever taxpayers need help related to tax problems. This relationship is believed to be able to give birth to trust, which is then expected to have a positive influence on tax compliance. A friendly approach to tax compliance is highly effective compared with deterrence (Mascagni & Nell, 2021, p.588).

## **2.6 Tax Compliance**

There are several different opinions raised by several authors regarding the definition of tax compliance. For example, Kirchler (2007) considered tax compliance as the most neutral term to describe “taxpayers’ willingness to pay their taxes” (Kirchler, 2007, p.21). In comparison, James and Alley (2002) said that tax compliance is a decision made by taxpayers to agree with the objectives of various policies related to taxation coupled with a cooperative attitude towards the community (James & Alley, 2022). Andreoni et al. (1998) and Song et al. (1978) in Widiyanto (2015) stated that tax compliance is a taxpayer’s willingness and ability to adhere to and demonstrate compliance towards the tax system to support the national economy based on ethics, legal environment, and other factors under a self-assessment system (Widiyanto, 2015, p.12).

As a country that adopts a self-assessment as its taxation system, Indonesia relies heavily on voluntary tax compliance. Nurmanto and Chayonowati (2016) in Waluyo (2020) stated that tax compliance is a behavior shown by taxpayers to fulfill all their tax obligations and carry out all their tax rights (Waluyo, 2020, p.677). Furthermore, they stated that there are two compliances adopted in the tax system in Indonesia, namely formal compliance (compliance related to formal matters such as payment, reporting, Etc.). On the other hand, there is also material compliance (compliance related to material aspects, such as the correctness of the contents of the annual tax return, Etc.). These two types of compliance are further regulated in a law that is specifically issued internally by the DGT, which is numbered SE-05/PJ/2022. From some of these definitions, it can be concluded that tax compliance is a behavior that is owned by a taxpayer, which describes a taxpayer’s willingness to fulfill his tax obligations.

## Chapter 3 – Contextual Background

### 3.1 Introduction

This chapter will specifically discuss the existing tax system in Indonesia. The discussion will focus on a brief description of the criteria for MSMEs according to the Indonesian law, as well as tax rules specifically issued by the government for these MSME actors including the applicable tax rates, how to pay, and how to do tax filing and what to prepare. This chapter will also generally analyze some of the circumstances that lead to why ‘stick’ policies are challenging to implement, or at the very least, difficult to implement for MSME taxpayers. The purpose of this chapter is to provide a comprehensive picture of the existing tax system in Indonesia before finally linking it to some of the concepts that determine tax compliance, as discussed in the previous chapter.

### 3.2 What is Micro, Small, and Medium Business (MSMEs) and what and what tax rules specifically regulate them?

#### 3.2.1 MSMEs in Indonesia

Not all individuals who own a business can be categorized as MSME entrepreneurs. On July 4, 2008, the Government of Indonesia officially passed Law No. 20 of 2008, which regulates micro, small, and medium enterprises (MSMEs). The most substantial consideration to passing this law was because the government feels it is crucial to integrate the MSME sector into a people’s economic activity (*Ekonomi kerakyatan*<sup>14</sup>).

Law number 20 of 2008 replaces law number 9 of 1995 which regulates small-scale economic activities. At that time, this law was deemed unable to provide legal protection and legal certainty for micro and medium scale business actors, which at that time their number was increasing rapidly.

The following are the criteria for micro, small and medium-scale enterprises based on law number 20 of 2008

**Table 2. MSME based on law number 20 of 2008**

	Category	Definition	Annual Sales (equals to USD <sup>15</sup> )
1	Micro	productive businesses owned by individuals and/or an individual business entity	Rp 50.000.000 – Rp 300.000.000 (about \$3,200 - \$19,203)
2	Small	productive economic business that stands alone, which is carried out by individuals or business entities that are not subsidiaries or not branches	Rp 300.000.000 – 2.500.000.000 (about \$19,203 - \$1,600,230)

<sup>14</sup> See Marhana (2019). The concept of People's Economy is an economic concept that was first coined by the first president of Indonesia, Soekarno, in an article written in 1933.

<sup>15</sup> Based on Google currency on Tuesday, 1 November 2022

		of companies that are owned, controlled, or become part either directly or indirectly of Medium Enterprises or Large Enterprises	
3	Medium	productive economic businesses that stand alone, which are carried out by individuals or business entities that are not subsidiaries or branches of companies that are owned, controlled, or become a part either directly or indirectly with Small Enterprises or Large Enterprises	Rp 2.500.000.000 – 50.000.000.000 (about \$1,600,230 - \$3,200,460)

Any type of business that does not meet the criteria mentioned above, by law, is considered a large business.

### 3.2.2 Tax for MSMEs

To lift tax compliance among MSMEs taxpayers, the government issues special tax laws specifically designed for them. This law allows these taxpayers to settle their tax obligations with a lower rate, a more straightforward calculation method, and a simple reporting system. The first law passed by the government is PP No. 46 of 2013, which provides a final rate for small and medium businesses at 1% multiplied by gross income for one month. The income limit for taxpayers to be able to use this facility is 4.8 billion Rupiah for one year.

Then in 2018, the government revised the regulation through PP 23 of 2018 and provided further relief by lowering the tariff from 1% to 0.5%. The income limit for enjoying this facility is still the same as the previous regulation.

Finally, in 2021, MSMEs actors are again ‘spoiled’ by the government through the Harmonization of Taxation Law Number 7 of 2021, which stipulates that MSME actors who still have gross income below 500 million Rupiah for one year do not need to make any payments<sup>16</sup>. Anyone who exceeds 500 million a year in income and is still below 4.8 billion rupiah for a year can still enjoy the final tariff facility of 0.5%.

**Table 3. Tax Laws on MSMEs in Indonesia**

Number	Law	Rate	Limit (in USD <sup>17</sup> )	Status
1	PP 46 of 2013	1%	IDR 4.8 billion a year (equals to \$307,244)	Replaced
2	PP 23 of 2018	0.5%	IDR 4.8 billion a year (equals to \$307,244)	Replaced

<sup>16</sup> This law does not require MSME business actors with income below 500 million Rupiah for one year to have a tax identification number (TIN). This policy is done considering that the system will automatically deactivate all TINs that have not had payment/or reporting for two consecutive years.

<sup>17</sup> Based on Google currency on Tuesday, 1 November 2022



3	Harmonization of Taxation Law Number 7 of 2021	0.5%	Start from IDR 500 million – 4.8 billion a year (\$32,005 - \$ 307,244)	Implemented (from 2022-now)
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Source: tax laws in Indonesia, edited by author

The changes in this law intended to improve MSME taxpayer compliance by prioritizing a simplification scheme for calculating, reporting, and imposing one type of tax and providing a stimulus to the informal economy sector. The government also hopes that the issuance of this regulation can encourage the public to participate more in formal economic activities. In addition, with this regulation, taxpayers from the MSME sector can understand the applicable tax rules so that they can automatically increase their tax-mindedness, which in turn can share knowledge with fellow MSMEs (Poernomo, 2020, p.935).

### 3.3 Why is it hard to make them comply?

#### 3.3.1 *The weak role of 'fear' in tax policy*

One of the psychological elements that can be a trigger for someone not to take action is fear (Groves, 1923). If we refer to the statement, it is clear that fear is not always present, or at least not strong enough, to be considered by the Indonesian people when faced with activities to fulfill their tax obligations. This statement is reflected in the level of tax compliance which is still relatively low (as evidenced by the performance report of the Directorate General of Taxes of the Republic of Indonesia, which states that the level of annual tax payments and reporting has not yet reached the expected figure). Not a few researchers think that the element of fear is one of the critical components of social adjustment. Some researchers even consider fear as one of the most potent ways of behavioral activation (operating condition).

Groves (1923), in his book, recounted a situation where savage people were walking in the forest. On the way, the man came across a food he had never eaten before in his lifetime. Without wasting the opportunity, he ate the food until it was gone. However, Groves continued, the person eventually realized that the food was leftovers from the king's meal. Moreover, realizing what he was doing was wrong because touching whatever the king had touched was taboo for a commoner, the person became very frightened. He also imagined the severe punishment he would receive from his tribal chief if he found out about this. The intense fear he experienced slowly made him sick, and soon after, he died (Groves, 1923). Another story is that there was a child who was strong and healthy. One day the child ate a portion of food that was not meant for his age to eat. He then realized that it was wrong, and he had the thought that he would not be able to grow up and death was coming closer, then the child was dying within three weeks of it (Ibid). "The operation of taboo in a primitive society constantly illustrates the tremendous meaning of fear in the life of savages" (Groves, 1923, p.81).

After understanding the story above, the government does not necessarily have to create a policy with an element of fear so significant that it must make people afraid of taxation itself. This frightening situation is feared to turn back to the government itself because, as already explained by Feld et al. (2006), that excessive restraint (it can be assumed by giving excessive fear) will result in a decrease in individual motivation to comply with the tax system (Feld, 2006). Groves (1923) stated that fear, as is commonly experienced, originates

from the thoughts that appear in consciousness rather than from actual situations in the outer environment that need to be reacted to in such a way as to protect one from danger. “This change of emphasis leads to the magnifying of the social causes that bring about fear, and also of the social consequences of the fear produced” (Groves, 1923, p.87). The fear that comes from something like this is what the author considers less than the current government policies (for MSME taxpayers).

It can be seen from this table, which provides an idea about how weak the fear of tax policy in Indonesia regarding tax law enforcement. The following table shows the penalties arising from non-compliance with tax obligations from several neighboring countries in Indonesia. The selection of countries is based on several countries with similar GDPs, namely ASEAN countries.

**Table 4. ASEAN countries’ tax penalty comparison**

Country	Non-compliance act	Penalties	Explanation
Singapore	Late payment	5%	of the amount of tax due
	Late payment and continued	5%+1%	1% given to each month late
Malaysia	Failure (without reasonable excuse) to furnish an Income Tax Return Form.	200 to 20,000 Ringgit Malaysia/ Imprisonment for a term not exceeding 6 months / Both	1 RM equals to 0,21 US Dollar. <sup>18</sup>
	Late payment	10%	of the amount of tax due
Thailand	Failing file tax return	200%	of the amount of tax due
	Late payment	1,50%	of the amount of tax due
Philippines	Late/fail file tax return	25%	of the amount of tax due
	Late/unpaid payment	20%	of the amount of tax due
Indonesia	Late/fail file tax return	Rp100.000	1 IDR equals to 0,000064 US Dollar <sup>19</sup>
	Late payment	based on MoF Interest Rate	of the amount of tax due

Source: the official website of the government of each country, edited by author

By comparing it with several penalties imposed by neighboring countries, it is clear that Indonesia’s penalty is very low. No one will feel fear of that penalty. My experience work-

<sup>18</sup> Based on Google currency on Tuesday, 1 November 2022

<sup>19</sup> Based on Google currency on Tuesday, 1 November 2022

ing as a tax officer for eight years also made me feel the same way. Many taxpayers I meet would be pleased to pay a fine of 100,000 Rupiahs (equivalent to 6.47 USD) every year for not reporting taxes, when compared to having to report tax returns and declare their assets to the DGT and causing the tax they must pay could be significantly more than the 100,000 Rupiah.

That is why the fear that should be contained in the stick policy must be able to generate the idea in the heads of taxpayers that if they commit tax violations, they can suffer losses. Alternatively, in other words, creating a modern version of the taboo.

#### ***3.4.1 Low number of tax officers***

OECD data on reading performance for PISA places Indonesia in the last position as the country with the worst reading performance (OECD Data, 2018). With an average score of 358, Indonesia ranks 40th out of 40 countries surveyed. This figure is still below the average of other OECD countries, which is 472 (ibid). The low reading interest of the Indonesian people is one of the most significant factors that make individual taxpayers greatly depend on tax officials in fulfilling their tax obligations (due to insufficient knowledge of the applicable tax system and rules).

To respond to this, the government, through the Directorate General of Taxes, created a position (which was later referred to as Account Representative/AR) that is expected to be one of the primary keys to extracting potential state revenues in the field of taxation. Their job is to carry out tax intensification through the provision of guidance/appeals, consultation, analysis, and supervision of Taxpayers. The duties of the Account Representative are stated in government regulation number 79/PMK.01/2015, which states that while carrying out their duties, AR must carry out service and consulting functions and carry out an activity of monitoring and extracting tax potential from taxpayers.

The problem is that the limited number of ARs (ranging between 20-30% of the total employees in one tax office) is very disproportionate compared to the number of existing taxpayers. Suppose the total number of tax employees is only 44,928 (data from the Ministry of Finance's Human Resources Bureau). In that case, there are approximately 9000 Ars who must be ready to provide guidance and supervision of taxpayers, which ranges from 49.8 million taxpayers.

Considering the facts above, we can analyze that it does not matter how scary the fines and tax sanctions listed in the laws are if the taxpayer does not know that these fines and sanctions exist. With a limited number of personnel, it would be logical also for tax officials to layer each existing taxpayer by sorting them from large taxpayers who can provide the highest tax revenue to the lowest. If it is like this, small entrepreneurs will occupy a lower layer and may receive less serious attention from tax officials.

#### ***3.4.2 A bitter step that must be taken by the government (a trade-off)***

In less than 10 years, the government has issued three regulations that specifically regulate tax obligations for individual taxpayers who work as MSME entrepreneurs<sup>20</sup>. These three

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<sup>20</sup> Detail information about these laws was explained on section 3.2

regulations offer a significant reduction in tariffs compared to the rates set before these three regulations were enacted.

The enactment of this rule is not without reason. In the strategic plan book issued by the Directorate General of Taxes for 2020 to 2024, the government is actually aware that the granting of concessions in terms of tax rates for MSME business actors is a policy that presents a trade off with law enforcement activities. The government reasoned that this reduction in tax rates was the right step to create conducive economic conditions, especially after the COVID-19 pandemic took place. At least, the government gave reasons, for the short term, tax revenue and the tax ratio will decrease. But in the long term, this will pay off if the economic foundation in the MSME sector has strengthened. This strengthening will also bring new business actors who are ready to become the next taxpayer.

### **3.4 Assessing, paying, and filing tax return for MSMEs**

As discussed in the previous section, MSME taxpayers have their own tax rules that are specifically applied to them. Indeed, not just any individual taxpayers and corporate taxpayers can use this rule. There are several ways that the government uses to screen people or entities that can use this rule. And the first step is:

#### ***3.4.1 Assessing the income<sup>21</sup>***

To determine which taxpayers are entitled to use this regulation, the government states that individual and corporate taxpayers must have a gross income within the limit of 4.8 billion Rupiahs (equals to \$307,244.16<sup>22</sup>) for one year. Indeed, there are several business criteria and taxpayer criteria that the government excludes from using this law even though their income is still below 4.8 billion rupiahs<sup>23</sup>. One-year gross turnover, as referred to in this regulation, is gross income for one year resulting from the combination of husband-and-wife income (if the individual taxpayers are married), and gross income for one year resulting from the combination of branch income (for corporate taxpayers).

#### ***3.4.2 How to pay tax***

Tax payments are made monthly by multiplying the gross income for one month at a rate of 0.5%. Taxpayers whose taxes are not collected by the tax collector (withholding) must calculate and deposit their taxes. After calculating, taxpayers can make e-billing independently through a web-based tax application or come to the nearest tax office to request e-billing before the billing code is paid at the bank or post office. The proof of payment must be kept by the taxpayer as proof of tax payment when it is time to report the annual tax return next year.

#### ***3.4.3 Filing tax return***

To do tax reporting, MSME sector taxpayers must know what form to use. According to the rules, the form that must be used is form 1770. To obtain this form, taxpayers can go

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<sup>21</sup> All explanations, how to assess, and how to pay taxes will refer to Government Regulation (PP) number 23 of 2018. This PP is the last legal basis that is applied to MSME taxpayers before the author finally writes this research. The existence of the latest rules that apply at the time of writing this research will not be used as a reference.

<sup>22</sup> Based on Google Currency on Tuesday, November 1, 2022

<sup>23</sup> All details of the types of businesses that are excluded from this rule can be read in Government Regulation number 23 of 2018

to the official tax website or the nearest tax office. Likewise, for reporting, taxpayers can easily do it through a website that has been prepared with an e-form mechanism. They can also come to the tax office directly to submit a filled form or even send it via postal service with the destination address of the tax office where the taxpayer is registered. In order for the process of filling out Form 1770 to run smoothly, taxpayers are also expected to be able to prepare proof of tax payments that have been made (photocopies or scanned documents), family cards, a list of assets, a list of debts, and records of turnover arranged by month.

### **3.5 Discovering and punishing tax evader**

#### ***3.5.1 Discovering***

With the enactment of PP 23 of 2018, making tax obligations for MSME actors is simple if compared to another type of regular taxpayer. The tax obligations they only have to do are payments (performed every month), and annual tax returns (done every year). This simplicity makes the tax office relatively easy to determine whether an MSMEs taxpayer is compliant just by looking at the fulfillment of these two obligations.

With an integrated system, an AR can monitor the tax activities of an MSMEs taxpayer. They will quickly see if there is a void in payment or negligence in reporting. Suppose one or two of these incidents do occur. In that case, AR is obliged to communicate to the non-compliant taxpayer to inquire about the difficulties they might face in terms of fulfilling their tax obligations. There is a rule regulating how AR writes letters to taxpayers indicated to be non-compliant, namely rule number SE-39/PJ/2015. Through a letter called SP2DK (Letter of Request for Explanation of Data and/or Information), an AR can communicate to a taxpayer about their non-compliance act. Also, through this letter, an AR can even send SP2DK letters to taxpayers who 'look' obedient if there is data found from a particular party that turns out that the data was not reported correctly by that MSMEs taxpayer.

#### ***3.5.2 Punishing tax evader***

Before the audit is finally carried out, the tax officer (in this case, AR) will carry out a series of supervisory actions in which these activities involve several applications that can only be used by tax officials. Quoted from an open material book on tax audits issued by the DGT, tax law enforcement does not necessarily begin with the imposition of administrative sanctions. However, at an early stage, the law enforcement process begins with an effort to remind citizens who already have tax obligations (taxpayers) by sending them appeal letters and warning letters (Directorate General of Taxes, 2016).

Furthermore, they explained that the process of 'punishing' taxpayers who did not comply with the existing system was divided into four major parts, which is:

- a. **First stage**, the DGT will provide an appeal letter for anyone who has met the subjective and objective requirements to register themselves at the tax office and get a TIN. Moreover, registered people will give a warning letter to carry out their tax obligations correctly. The DGT will not impose administrative sanctions at this stage because they still provide opportunities for tax evaders to correct their obligations.

- b. Second stage**, if the appeal letter and warning letter are not heeded, the DGT will issue an administrative sanction. For tax evaders who have not registered at the tax office, the DGT will forcibly issue an NPWP accompanied by the principal tax payable and administrative sanctions attached<sup>24</sup>. Moreover, for those who have registered at the tax office, if they do not carry out their obligations properly the DGT will only issue administrative sanctions and fines through a Tax Collection Letter (STP).
- c. Third stage** is a tax audit. Generally, this stage is used if there is material tax non-compliance. The tax audit can be carried out after the first two steps do not meet the proper settlement. The audit results will be fully contained in an Audit Result Report (LHP) which will later be used as the legal basis for issuing a Tax Assessment Letter (SKP). This tax assessment letter can contain three things; the first one is a letter stating that the taxpayer is underpaid (SKPKB), the second one is a letter stating that the taxpayer is paying zero (SKPN), and the last one letter stating that the taxpayer is overpaid (SKPLB). The rules that specifically regulate tax audits are in Article 29 of the KUP Law and the Regulation of the Minister of Finance Number 82/PMK.03/2011 in conjunction with the Director General of Taxes Regulation Number: PER-34/PJ.2011 concerning procedures for tax audits.
- d. Fourth stage**, which is also the highest stage, is the provision of sentencing decisions. This stage is carried out if the taxpayer commits a tax crime violation. This law enforcement is carried out by Civil Servant Investigators (PPNS) in a pro-Justitia nature and follows all stages of the preliminary evidence examination process, investigation, and prosecution if the judge has decided and is declared legally and convincingly guilty, then the process of punishing the taxpayer is carried out (Ibid).

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<sup>24</sup> Details of the fines and sanctions given can be seen in table 5

## Chapter 4 – Finding and Analysis

### 4.1 Introduction

This chapter will specifically describe the primary data obtained from the survey process as well as interviews. The number of people who took part in this survey was 101 people and 14 people for interview. This chapter will describe the survey results by dividing them into 4 parts according to the concepts discussed in chapter 2.

### 4.2 Analysis of Survey and Interview Findings

In this section, I will describe the results obtained from surveys that participants have filled out. At this stage, participants will read each question or statement and answer it by selecting the categories provided (Strongly Disagree to Strongly Agree). In addition to the Likert scale, I also include open-ended questions that are expected to provide more flexible and broad answers compared to the Likert scale. Analysis of survey findings will be followed by the analysis of data obtained from the interview process.

#### 4.2.1 Tax Morale

As discussed in chapter 2, that Tax Morale is a concept considered to represent a person's intrinsic motivation (Kirchler, 2007). Meanwhile, Intrinsic Motivation is described by Hands (2018) as a phenomenon where a person will be involved in an activity freely, without coercion, and being sustained by the interest and enjoyment (Hands, 2018, p.6). Therefore, the questions I made are divided into four categories: the desire to contribute to the country, the desire to be a good citizen, the pleasure in carrying out tax-paying activities, and the shame received if you do not fulfill your obligations as a citizen. The results that I got from the survey are as follows:

**Table 5. Survey findings related to the concept of Tax Morale**

	I pay taxes because I am a person who wants to contribute to the country	Percentage	I pay taxes because I want to be a good citizen	Percentage	I enjoy paying taxes	Percentage	I feel ashamed if I don't do my tax obligations well	Percentage
Strongly Agree	39	39%	40	40%	27	27%	39	39%
Agree	44	44%	45	45%	36	36%	44	44%
Neutral	16	16%	15	15%	29	29%	15	15%
Disagree	0	0%	0	0%	6	6%	2	2%
Strongly Disagree	2	2%	1	1%	3	3%	1	1%
Total Participant	101	100%	101	100%	101	100%	101	100%

Source: Survey, edited by author.

In the first statement, 44 people answered agree; in the second statement, 45 people answered agree; in the third statement, 36 people answered agree; in the last statement, 44 people answered agree. These numbers show me that these are people who want to contribute to the country. They want to be good citizens, love paying taxes, and would be ashamed if they failed to pay taxes. That number does not even consider the people who answered strongly agree. This figure gives me the conclusion that they have very high internal motivation, which will lead to high Tax Morale as well.

Besides using the Likert scale to get a broad answer, I also put an open question. In this question, I asked how the participants to assess their tax morale by relating it to their level of tax compliance. From all the answers collected, I did the coding and found the four answers that came up most often, which answers were related to:

- 1) Contribution,
- 2) Responsibility, and
- 3) Love for the country.

If we look at the three dominant answers, they attribute it to positive things, or things that show that their tax morale is good. However, there is one last answer that emerges is:

- 4) Compulsion.

This answer is quite the opposite of the dominant answer that appears. However, the number of people who gave this answer was insignificant compared to those who gave a positive answer. From this figure, in a very early stage, we can conclude that more than 50% (based on the number of people who answered Agree and Strongly Agree) have excellent Tax Morale.

I am moving to the interview section. From several people I interviewed, many of the answers I found attempted to link their tax morale with their awareness of tax laws and a desire to comply with those laws. Some even stated that they realize that taxes are a mandatory contribution to the state. Interviewee 1 answered, *“That is a must, it is regulated by law. As a good citizen, I must obey the law”* (Interviewee 1, 2022). The same thing was also said by interviewee 2, who stated that paying taxes was self-awareness *“I feel that paying taxes is one’s self-awareness. So that is how it should be”* (Interviewee 2, 2022). Some of the remaining answers also convey a similar thing *“Actually, I know that this is a tax obligation. There is also a law. The state lives from taxes. If not us, who else can build this country?”* (Interviewee 4, 2022). However, when I turned to questions meant to measure their ‘level’ of tax compliance, they began to show an inconsistency between word and deed. For example, Interviewee 4 said that *“It depends on the situation. I don’t feel that I am a very compliant person. When the situation is good, I pay taxes. If not, I am not compliant”* (Interviewee 4, 2022). Interviewee 5 added that *“My obedience is still a form of coercion. I am ‘forced’ to obey because someone is watching”* (interviewee 5, 2022). No voluntary compliance has occurred despite their high Tax Morale. Interviewee 6 added, *“I still feel being ‘forced’ to do it. It because the public facilities that the government provides me are not commensurate with the tax money I have paid. What is more, I live in a remote area”* (Interviewee 6, 2022).

At this stage, the survey and interview results support each other. They both stated that the participants have high tax morale (intrinsic motivation). However, it is not accompanied by high tax compliance (or at least voluntary compliance) as well. Further analysis will be provided in a separate section.

#### **4.2.2 Fiscal Contract**

In their article, Lars and Feld (2007) concluded that the reciprocal relationship between the government and taxpayers in providing public goods and satisfying services, augmented with a sound democratic system where public representation in government functions well, and a good relationship between tax officials and taxpayers are proven to influence tax morale. This condition, in turn, increases these taxpayers' willingness to fulfill their tax obligations (Lars & Feld, 2007). Therefore, in this concept, I ask a question that is intended to



give us an overview of the taxpayer's views regarding the facilities provided by the government by relating them to their tax payments so far. The results obtained are as follows:

**Table 6. Survey findings related to the concept Fiscal Contract**

	<b>Based on the amount of tax I paid, I am satisfied with the public facilities and services from the government</b>	<b>Percentage</b>
<b>Strongly Agree</b>	<b>12</b>	<b>12%</b>
<b>Agree</b>	<b>20</b>	<b>20%</b>
<b>Neutral</b>	<b>38</b>	<b>38%</b>
<b>Disagree</b>	<b>26</b>	<b>26%</b>
<b>Strongly Disagree</b>	<b>5</b>	<b>5%</b>
<b>Total Participant</b>	<b>101</b>	<b>100%</b>

Source: Survey, edited by author

From 101 participants, it was found that as many as 38 people answered with a neutral answer, followed by disagree answers with a score of 26%, and agree answers with a score of 20%, strongly agree with a score of 12%, and the least answer is strongly disagree with a score of 5%. This answer is quite balanced because if it is divided into three large groups between people who agree, neutral, and disagree, each answer will have a relatively similar percentage.

From those results, I conclude that a reasonably balanced answer is because the facilities received by each community may be different. Since people from various regions in Indonesia filled out this survey, their experiences will be very different, resulting in mixed answers.

To provide a comparison, I will also present the results of the answers to open questions that I put in the survey. This question was answered by 91 people out of a total of 101 surveys that returned, while ten people chose not to answer anything in this open-ended question. From the coding results, there are three different answers:

1. they do not get good returns from the government for the taxes they pay (mentioned by 56 people),
2. the government facilities are good (mentioned by 22 people),
3. neutral answer (mentioned by 13 people),

At this stage, there was a discrepancy between the answers I got from the Likert scale and the answers I got from open-ended questions. Compared to a rigid answer, in this open-ended question, participants are allowed to be more open and vent about the complaints they currently receive. The answers I get are dominated by stories about how they do not get good facilities from the taxes they have paid.

To strengthen my analysis, I summarize some answers from the interview session. For example, Interviewee 9 said that *“There are still many roads that are not good, and I believe that is the result of tax money not being properly absorbed for development. Development is still uneven”* (Interview-

ee 9, 2022). Interviewee 12 added, “I have lived in two different places, namely Jakarta and Bali. Where I live now is in Bali, and I dare to say that public transportation in Bali is terrible when compared to when I lived in Jakarta” (Interviewee 12, 2022). Interviewee 1 also expressed something similar, “If I have to answer honestly, I don’t feel satisfied. Right now, I feel enough, but if I have to travel from one area to another, there are still many damaged roads. And it shows uneven development” (Interviewee 1, 2022). Interviewee 6 added, “Not worth it because I live in a remote area” (Interviewee 6, 2022)

The answers obtained from the open-ended questions and the interviews supported each other. Both answers give me the idea that most people stated that the public facilities they received from the government were not up to the standard they expected. Although the results of the survey do not show much, where the answers I get ‘tend’ to play it safe. Alternatively, if I had to analyze it further, I thought that a balanced answer was obtained because of the regional diversity of the survey participants. One survey participant may live in a big city with all good public facilities, whereas the other participant lives in a remote area with minimal facilities. This condition further sharpens my analysis that the existing facilities are not evenly distributed.

Hamar et al. (2009) emphasized that tax compliance is strongly influenced by public trust in policymakers/politicians (to provide suitable facilities evenly) (Hamar, 2009, p.244). If this has yet to be met, it is likely that tax compliance will remain low.

#### 4.2.3 Tax Law Complexity (Subjective Knowledge)

With this concept, I intend to find out the attitude of individual Indonesian taxpayers toward the tax rules that the government has made. Through its statement, the Indonesian government claims that the tax laws for individuals specifically for MSME business actors have been made as easy as possible with low rates. These laws are intended to increase the number of new registrants. To get an idea of the public’s knowledge of taxation rules, I divided it into four statements that intend to find out the public’s perception of the applicable tax rules. The results obtained are as follows:

**Table 7. Survey findings related to the concept of Tax Law Complexity**

	Simple tax rules can make taxpayers more obedient to their tax obligations	Percentage	The current tax rules are easy to understand	Percentage	I am actively looking for the most recent tax regulations	Percentage	I know the latest tax rules	Percentage
Strongly Agree	37	37%	8	8%	16	16%	11	11%
Agree	50	50%	23	23%	26	26%	25	25%
Neutral	10	10%	47	47%	39	39%	43	43%
Disagree	3	3%	17	17%	17	17%	16	16%
Strongly Disagree	1	1%	6	6%	3	3%	6	6%
Total	101		101		101		101	

Source: Survey, edited by author

When faced with a statement stating that simple taxation rules can increase a person’s level of tax compliance, as many as 50% of participants answered agree, and even 37% answered

strongly agree (only 1% strongly disagree). However, the situation began to change when they were faced with a statement stating that the current tax rules applied by the Indonesian government were easy to understand. The most dominant answer was Neutral, which was 47% of participants. Followed by the answers Agree (23%) and disagree (17%). At this stage, they still feel doubtful about whether they know or do not know.

The author then added a statement that intended to find out whether the participants were actively seeking to know about the new tax rules. Moreover, the result was again dominated by Neutral answers, which was 39%. Lastly, the fourth statement is intended to find out whether the participants are aware of the latest tax regulations, and the dominant answer is still Neutral, with a total of 43%.

To provide a comparison of the results of the Likert scale, which is dominated by neutral answers, I will try to explain the answers to open questions that I included in the survey. I will divide the answers to these open-ended questions into three categories according to the coding I have prepared. The three categories are

1. people who do not understand at all,
2. people who know but do not know much, and
3. people who understand.

The answer to this open-ended question is dominated by people who do not understand the tax rules at all. 43 people answered that they did not understand and did not actively seek to find out. This is because tax officials do not give them socialization, and on the other hand, some think that the existing rules change every now and then, which makes them confused. The second answer is dominated by people who know but not in depth. 39 people gave this answer. The members of this coding consist of people who claim to know the tax rules but are only about the obligation to pay. The knowledge about changes in tariffs, the obligation to report taxes, and so on they have yet to learn for sure. Moreover, the last answer is filled by people who know the tax rules. This answer was given by 17 people, while two people chose not to answer anything.

Moving to the interview part, the same as the answers contained in the open-ended question, The people I interviewed were also divided into three broad categories; taxpayers who know in detail the current regulations in, taxpayers who have shallow knowledge, and taxpayers who don't know (or don't want to know) at all. For example, for the one who stated that they are known to tax rules very well, Interviewee 13 stated that *"Yes. I know. Because it turns out that there is a member of my family who works as a tax consultant. I learned a lot from him"* (Interviewee 13, 2022). Interviewee 2 added, *"I only knew from consulting activities that a tax officer came to our place. After that I didn't know, and I didn't actively find out"* (Interviewee 2, 2022). And finally, the one who didn't know at all, Interviewee 12 where he said, *"I don't know, and never found out about the tax rules"* (interviewee 12, 2022).

At this stage, the answers I got from open-ended questions and the answers I got from the interview session gave me an idea of how taxpayers are divided into three major sections as I have previously divided. I can only get a little out of it if I reflect on the survey answers. The only thing I can get from the survey table is that taxpayers agree that simple tax rules can make taxpayers more obedient to taxation systems. So, are the survey results correct? We need to move on to further analysis sessions to be able to conclude the answer.

#### 4.2.4 Interactions between taxpayers and tax authorities

In this concept, the statements that I gave to the survey participants were divided into four. The four statements were aimed at finding out the public's perception of friendly tax officers, employees who were proactive in approaching taxpayers, tax officers who were always suspicious, and law enforcement activities (examinations, sanctions, fines, etc.) with taxpayer compliance. Just like the previous sections, I also completed this session by sharing coding on the answers I got from open-ended questions.

**Table 8. Survey findings related to the concept of Interactions between taxpayers and tax authorities**

	Tax officers who show friendly attitude will make taxpayers more willing to fulfill their tax obligations	Percentage	Tax officers who actively contact and establish good relations with taxpayers make taxpayers more willing to fulfill their tax obligations	Percentage	Tax officers who are strict, always suspicious, and often threaten to carry out inspections will make taxpayers more obedient to tax rules	Percentage	Law enforcement actions (such as inspections, sanctions and fines) will be effective in improving tax compliance of a taxpayer	Percentage
Strongly Agree	40	40%	34	34%	15	15%	29	29%
Agree	32	32%	36	36%	11	11%	27	27%
Neutral	24	24%	27	27%	27	27%	30	30%
Disagree	3	3%	3	3%	23	23%	7	7%
Strongly Disagree	1	1%	1	1%	24	24%	8	8%
Total	100		101		100		101	

Source: Survey, edited by author

For the first statement, as many as 40% of people strongly agree that a good attitude shown by tax officers can improve tax compliance, of which 32% agree. Turning to the second statement, answered with strongly agree and agree by 34% and 36%, they agree that tax officers who actively approach taxpayers will improve tax compliance. In the third statement, although it was dominated by people who answered disagree and strongly disagree (23% and 24%), there were still people who were neutral on the statement (27%). In this statement many people doubt, but the majority do not agree that officers who are always suspicious will make taxpayers more obedient to tax rules. The last statement was dominated by people who answered neutral (as much as 30%).

The temporary conclusion that I got from just reading the survey results is that most people agree that tax officers who have a friendly nature, can establish good relationships, and actively approach them can improve taxpayer compliance. This is in line with several scholars' opinions who also express the same.

In the third and fourth statements, I found answers that were dominated by neutral choices. They tend to be unsure whether rigid, firm tax officials, as well as law enforcement instruments such as fines and administrative sanctions, can improve tax compliance or not. Or, in my opinion, they actually know that it can improve tax compliance, but too afraid to admit that. However, they still prioritize good and friendly tax officers to pursue them to become obedient taxpayers. They want tax officials to behave like chameleons who can adapt according to the taxpayers they handle, whereas when dealing with good taxpayers, they are friendly and vice versa.

For interview parts, in this session I found several answers that support the analysis I made based on the survey results. Interviewee 14 stated *"Yes, based on my last interaction to tax officers, they were kind enough and willing to help with some tax issues I had. I want all tax officers like that. There is no need to assume that these taxpayers in Indonesia are criminals"* (Interviewee 14, 2022). Furthermore, Interviewee 11 stated *"I give it an 8 (out of 10) score based on my last interaction with the tax officer. I want a friendly and helpful staff. Because if it's friendly, I won't create a barrier between us. On the other hand, when the tax officer I met for the first time was unfriendly, I would create a barrier, and that was not good at all"* (Interviewee 11, 2022). Interviewee 1 stated that there was a different treatment from each tax officer. *"I want officers who can accept that the business world is not always productive. Because business has its ups and downs. Sometimes the tax officer likes to chase me and is suspicious of me if I declare that I have no income, even though the economic conditions are difficult"* (Interviewee 1, 2022).

From this, the conclusion can be drawn is that people want friendly and nurturing tax officers who become officers they can trust, but on the other hand, they also want solid and firm penalties for those who do tax evasion. The combination of the two attitudes is what is expected of this taxpayer. In line with these findings, Kastlunger et al. (2013) also explained that *"Depending on the climate, citizens either need to be enforced to comply or they cooperate voluntarily"* (Kastlunger et al., 2013, p.37).

Furthermore, Kastlunger et al. (2013) said that:

*"...to achieve cooperation within a society, two different paths are possible. The first path stresses the authorities' power to regulate citizens' behaviour. Tax compliance is enhanced by external incentives, predominantly by audits and fines. The second path stresses taxpayers' and the authorities' interaction style, mutual trust, and commitment to the society in which they live. Trust is defined as a relational variable providing the base for voluntary cooperation. If trust is high, taxpayers perceive a duty in fulfilling societal needs. Both approaches promise high tax contributions, either by exerting power or by strengthening trust."* (Kastlunger et al., 2013, p.37)

### **4.3 Further analysis**

From the analysis of the findings obtained from the survey process and interviews using the four psychological factors that became the topic of this research, there is still a big question left. This is based on the fact that the Tax Morale owned by individual MSME taxpayers is high (see the Tax Morale section), but tax compliance is still declared low by the government. Participants rationalized their non-compliance by saying that the Fiscal Contract they received was not fully maximized (see Fiscal Contract findings). They gave other reasons related to their unsatisfactory relationship with the tax officer (see section Relationship between tax officer and taxpayer). Fiscal Contracts that do not meet their expectations and tax officers who do not protect are exacerbated by the behavior of these individual taxpayers who do not actively find out about the latest tax rules. They passively wait for the tax officials to counsel them without any initiative to find out the existing regulations, despite the high Tax Morale. This phenomenon is an inconsistency between Tax Morale and tax compliance. And to 'justify' their actions, they blame the other three factors because they are not satisfied with what they receive.

#### ***4.3.1 Cognitive Dissonance***

A person's high tax morale does not necessarily make them a good taxpayer. Cognitive dissonance, a concept in psychology that occurs, may make them consider two alternatives for their actions and will eventually make them rationalize their choices. This condition is expressed by Brehm (1962), that stated: "how dissonance may be aroused and reduced when a person chooses between two attractive alternatives" (Brehm et al., 1962, p.5). "Cognitive dissonance, according to Festinger (1957), is a psychological tension having motivational characteristics" (Brehm et al., 1962, p.3). Furthermore, Brehm (1962) said that to measure this theory in units, cognitive elements are used (interconnected between one unit and another). This cognitive can also be said as "knowledge," or it can be said as items of information. They may relate to oneself or one's environment, such as "knowledge of one's feelings, behavior, and opinions as well as knowledge about the location of goal objects, how to get to them, what other people believe, and so forth, are examples of cognitive elements" (ibid).

Information or ideas describing how a group of people with the same characteristics can live in peace even though they have committed a tax violation will gradually affect someone. At this stage, I suspect that if a person during his daily life is exposed to the fact that people who do not comply with taxation can live 'peaceful' life, that person will make "non-compliance" an attractive alternative regardless of how high the tax morale they have.

#### ***4.3.2 Ease of filling out tax reporting forms***

I did a small test to test the ease of the tax system that the government promised. I held a small activity by asking ten random people from various educational backgrounds to fill out a tax return form. I deliberately chose tax return activity because this system is considered troublesome by MSME taxpayers. Filing a tax return is also one indicator of tax compliance. Not only payments, but the government is also trying in such a way to make the tax reporting process easy and convenient to do. Through tax regulations number PER-03/PJ/2015, the DGT applies an online-based tax reporting system known as e-Filing. E-Filing is an alternative tax reporting for individual and corporate taxpayers by prioritizing convenience and real-time principles. Finally, this small experiment found that the average time it takes a person to fill out is 28.5 minutes.

The findings from my little experiment were supported by several studies that tried to analyze the effect of implementing e-Filing on the level of tax compliance. One of them is a study conducted by Setiawan et al. (2018), where they examined the effect of e-Filing on tax compliance by involving 750 individual taxpayers spread across five tax offices in Central Java province. One of the factors they use to analyze tax compliance is the ease of using the application. The study results show the mean score of the application's ease of use of 4.050. The scale they use is a Likert scale where the number 1 on this scale indicates that e-Filing is not helpful, and a scale of 5 indicates that e-Filing is very useful. By comparing these two things, the score obtained from the perceived ease of use of e-Filing, they conclude that e-Filing is easy to use and positively affects a person's level of tax compliance (Setiawan et al., 2018).

It can be concluded that the tax system, especially the filling of tax reporting forms, has been designed in such a way as to be easy to fill in a relatively fast time duration (provided that the supporting documents have been prepared beforehand. Details of these docu-

ments are in chapter 3). This makes it clearer that there is an inconsistency between high tax morale and the difficulty level of the tax system and its effect on tax compliance.

## Chapter 5 – Conclusions

The main object of this research is to find out the initial perception of individual taxpayers in Indonesia when faced with tax obligation issues using psychological concepts/factors. Of course, this research is not a study that can provide a concrete picture of the phenomenon of low tax compliance in Indonesia. This research is the first step of a relentless effort that must be fought by the government and the people hand in hand in improving tax compliance in Indonesia. This research was also not intended to prove whether these factors influence tax compliance or not since it was already proven by other researchers, but rather an exploratory study that attempts to explain a causal event by referencing it to psychological factors. Just like Julianna D. Parra (2021) said in her research paper, "...my intention was not that of building new knowledge. Rather, I intended to outline "trajectories for thinking otherwise" (Parra, 2021, p.31).

### 5.1 Reflection and Methodological concerns

The mixed methodology I chose in this research helped me arrive at a more profound conclusion when compared to using only one method. Surveys helped me reach a wide range of participants from different areas, and I can get their perspectives from different points of view. On the other hand, the interview helped me to analyze this perspective more deeply, which, thankfully, if I did not conduct the interview, I could have come up with a shallow conclusion with such a high level of bias. In carrying out this research, I got different results in every data collection method that I did. The answers that participants gave me through the survey will differ from those they gave in open-ended questions and the answers given in the survey process. Moreover, the most surprising thing was that the participants remained the same of the three data collection methods I did. I did not take different participants for the interview; the survey participants were interviewees participant as well. It is not easy for me to analyze the reasons behind the participants' inconsistencies. They tend to put themselves in a bright spotlight when faced with questions that ask how much they love their country but tend to doubt, argue and even blame others when faced with questions that ask what actions they have taken as proof of their love for the state.

Besides that, the limited time is also an obstacle for me to get more comprehensive and varied results. Indonesia is a vast archipelagic country consisting of various ethnic groups, cultures, and norms that differ from region to region. Bringing this diversity into a study that is only carried out for approximately 2 to 3 months takes work. With the various limitations that have been mentioned in the previous chapter, the best step I can take is to suppress the bias that might arise by conducting multimethod research.

Kirchler (2007) mentions, "studies on tax compliance have employed various research methods" (Kirchler, 2007, p.182). According to Baldry (1987), this situation is caused by the difficulty of researchers to obtain 'hard' empirical data, so in the end, they take their own data through surveys and experimental simulation (Kirchler, 2007, p.183). In social science, surveys tend to be associated with an economical way of getting data. Nevertheless, behind its advantages, surveys tend to have problems with the level of honesty of their filler (ibid).

My input for further research, for those who have a long duration of research, they can replace interviews with experiments and overcome the shortcomings of surveys by combining them with field experiments, because according to Kirchler (2007), "experimental ap-



proaches have the potential to address some of the weaknesses of other methods" (Kirchler, 2007, p. 186).

## 5.2 Answers to Research Questions

After all based on various findings, both from survey results, interviews, previous research, articles, news, and press releases related to this topic, the answers to the research questions are as follows:

*By looking at it from a psychological point of view, how is the current attitude of an individual taxpayer who owns micro, small, and medium enterprises toward the tax system in Indonesia?* Based on four psychological concepts, this study finds that the current attitude of an individual taxpayer in Indonesia can be different depending on what concept we look at. For example, regarding internal motivation, the survey results and interviews found that most participants had a high level of tax morale. This is reflected in most answers stating that they love Indonesia and how much they want to be good citizens. Some are even willing to increase their taxes if needed (stated by 7 out of 14 interview participants). The opposite results appear when it comes to fiscal contracts, where most participants stated that they were not satisfied with existing facilities. Likewise, with tax regulations, they feel that the current regulations are still very difficult to understand. The relationship between tax officers and taxpayers is the second-best thing after tax morale that I got from data processing, although there are indeed many improvements that need to be considered by DGT. It can be concluded that the current low level of tax compliance is due to different people's attitudes depending on which factor we look at. MSME taxpayers have Tax Morale and a good relationship with tax officials but are still reluctant to comply due to psychological implications that make them look for other factors as justification for their actions, which is poor facilities and complicated tax rules.

In line with the first sub-question that asks, *can one (or more) psychological factors be the only factor that can affect tax compliance?* Based on this research finding, this cannot happen because it turns out that tax morale and good relationship with tax officers are not enough to make Indonesia's tax compliance level high. I found an interesting interrelationship between each factor. I call tax morale is an internal motivation, while the fiscal contract, tax law complexity, and the relationship with the tax officer are external factors. These two things intertwine and complement each other. This is in line with the conclusion found by Hite (1987) in Kirchler (2007), which states that "if respondents are asked about their own tax behaviour, they tend to attribute evasion to external factors, whereas they attribute evasion to internal factors if they assume the role of other taxpayers" (Kirchler, 2007, p.185).

For example, if the taxpayer's tax morale is high, the level of tax compliance is not automatically high if the fiscal contract is still low. Alternatively, no matter how easy the government makes the tax rules, if the tax officials do not adequately serve them by providing good socialization, the public will still have a low level of knowledge, leading to a low level of compliance. Or, even though the government has provided good facilities, the tax morale of taxpayers is high, and the rules have been made as simple as possible, it will be useless if the tax officer behaves unfriendly and violently all the time indiscriminately.

Finally, to answer the last question, *what psychological factors should the government prioritize if they want to formulate a tax policy?* The government must carefully consider all factors. The results of surveys and interviews show a strong tendency for taxpayers to have high tax morale.

However, this possibility can mean two things: 1) as an effort to cover themselves from a bad habit, or 2) indeed, they have good internal motivation. However, assuming their tax morale is high because they love Indonesia and want to be good citizens, then it is the government's turn to do its job well. The government must be able to be trusted. Kirchler (2007) in his research found that "voluntary compliance is high if interaction with authorities is trustful and if citizens understand the law and perceive taxes as distributed fairly..." (Kirchler, 2007, p.205). However, if the opposite, if the morale that they show in this study is something that is just a way for them to cover themselves from bad habits, then this is a cognitive dissonance that leads to misbehaving, and this is a psychological problem. In the end, a psychological problem requires psychological-based intervention to overcome or a combination with economical-based intervention. For the next section, I will give some policy recommendation.

### **5.3 Policy Recommendations to combat cognitive dissonance**

#### ***5.3.1 Nudging***

One of the steps that the DGT can use to counter the cognitive dissonance among MSME taxpayers is to implement a nudging policy. Nudges are believed to influence a person's behavior relatively subtly. Graf (2019), in his Introduction to a book called a Handbook of Behavioural Change and Public Policy, says that "Nudges differ from other policy tools inasmuch as they are not supposed to convince the rational decision-maker by giving him or her reasons to act. In order to function they may, though they do not have to, enter people's explicit deliberative processes" (Graf, 2019, p.24). Compared with several policy products, such as criminal law, which will punish anyone who commits a crime, nudging seems invisible but clearly has a decisive role in a person's decision-making process.

Furthermore, Graf (2019) explains, "By contrast, behavioral policy instruments such as nudges address the decision maker in more subtle ways. They are designed to influence the outcome of decision-making processes by framing them in particular ways, setting default options, and changing the architecture or environment of the decision" (Ibid). Nudging is not consistently excessive, nudging is not always expensive, and nudging can take any form, but what is certain is that nudging has a tremendous impact.

The best example I can give is an example described by Angela Clegg (2019), in her article entitled 'HMRC's use of nudge theory on taxpayers', where she explains that there is an image of a fly in the male urinal, which men can't stand psychologically to target the direction of their urine when urinating at the fly image. This is nudging. Alternatively, for something more serious, nudges can be in the form of an appeal to save money for old age, which, surprisingly this appeal has been an enormous success for the retirement savings program (Clegg, 2019). Nudges work invisibly. People who receive them always have the choice to follow or not to follow the nudging.

In taxation, nudging can be the best solution to improve taxpayer behavior. Clegg (2019) stated that the UK, through HMRC, implemented a nudging policy by creating an Employee Benefit Trust (EBT) settlement opportunity in 2011. This program targets participants (who are also involved in tax avoidance schemes) to be able to consider choosing their settlement and using the EBT facility. Here HMRC provides contact assistance for anyone who needs assistance in preparing and calculating tax debts that have arisen so far due to tax evasion (Clegg, 2019). With the existence of EBT, these tax evaders voluntarily admit their non-compliance activities and improve their tax obligations in exchange for getting

EBT facilities. “This did appear a genuine nudge; the letters were not overly confrontational, agents were routinely informed, and taxpayers were given a choice” (Clegg, 2019).

The nudges theory is also applied by several researchers who try to analyze the increase in self-registration at the tax office by utilizing nudging. This study conducted by Schachtele et al. (2022) in Brazil found that there was a 400% increase in registrants after the tax office sent a letter asking people to register their property with the tax office (Schachtele, 2022, p2).

Some of the examples above are policies that the Indonesian government can emulate. By utilizing the three existing data points, namely high tax morale, an easy tax system, and experience in interacting with tax officials, I suggest that the appropriate form of nudges is send a letter (within a certain period) to MSME taxpayers in which the letter does not contain any ‘threat’ elements. The letter must be in a friendly tone, made as simple as possible, and purely for educational purposes only. The content can be about how necessary taxes are and how the government uses the tax money.

On a larger and more serious scale, this nudging policy can be related to the appearance of fear that comes from a taxpayer’s mind. The fear referred to here is fear which refers to the explanation of Groves (1923), which states that a modern fear is a fear that comes from a mindset/idea. The government can combine tax payments with public facilities such as health, education, electricity, gas, etc. Give them discounts and payment waivers as a form of ‘reward’ for their compliance. If taxpayers do not pay taxes properly, the ‘reward’ or incentives will be suspended until they finally pay off their obligations. The idea of losing these facilities because of non-compliance acts will become a natural ‘fear’ for them. In this way, compliance costs will decrease, which will also be a good thing for state revenues and companies that provide public services. With the increase in taxpayers, the state revenue will also increase, and the government can make budget payments for these companies whose services are used as a ‘reward’ for obedient taxpayers, in the end, these companies do not have to worry about losses.

### ***5.3.2 Increasing Tax Fines as a deterrence measure***

In line with the view of Kirchler (2007) which states that psychological factors may meet each other with economic factors, the DGT could increase fines and tax sanctions to create a stick that can give fear to tax evaders. Feldman and Slemrod (2009) state that no government can implement a tax system with a high level of voluntary tax compliance (Feldman & Slemrod, 2009, p.140). Taxpayers will always be divided into two, compliant taxpayers and non-compliant taxpayers. At first, people with high tax morale will have a high sense of responsibility to fulfill their obligations to the state by paying taxes. However, over time, this patriotism will decrease as they become more aware that many people out there are not carrying out their obligations properly. Feldman and Slemrod (2009) further said that “over time the ranks of dutiful would shrink, because they see how they are being taken advantage of by the non-dutiful” (ibid). During my eight years of experience as a tax officer in Indonesia, I often faced this free-rider problem. Many good taxpayers are reluctant to comply with the tax system because there are no benefits they can feel if they become a good ones. People who pay taxes and do not pay taxes will get the same facilities<sup>25</sup>, such as

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<sup>25</sup> This free rider phenomenon by Feldman and Slemrod (2009) is a person's step to maximize the benefits they receive as a human being. There is a standard model which assumes that individuals

access to public roads, schools, subsidized fuel, subsidized electricity, etc. Moreover, sometimes these facilities are also not in optimal condition. For example, roads are still in bad condition, the quality of teachers is still far below standard, subsidized fuel and electricity are not right on target, the health system is expensive, and so on.

Therefore, paying taxes should be described as legally binding. All forms of evasion carried out by non-dutiful taxpayers must be rewarded with the appropriate stick. Indeed, the results of surveys and interviews show that people want taxpayers who are friendly and not coercive with them. However, this would be a reckless act if it was done to all taxpayers. Firm and measured action must be given to taxpayers who deserve to receive punishment. The current low level of fines imposed by the government also needs to be revised in efforts to increase the level of tax compliance, especially among MSME entrepreneurs. Reducing tariffs, as a trade-off, is an appropriate step to increase economic activity. However, low fines and low administrative sanctions are not a trade-off that the government must take. This will be a gap that tax evaders can take advantage of to avoid their obligations, which can result in a potential loss for the state.

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are free riders. In making decisions, they tend to ignore the impact on others (Feldman and Slemrod 2009, p.139)

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## Annex A

### List of Interviewees

No	Name	Type of Entrepreneur	Size of Business (based on law number 20 of 2008)	Registered Status at tax office	Income range per one year	Location of business
1	Interviewee 1	Selling garment goods	Small	Yes	50-250 Million Rupiah	West Kalimantan Province
2	Interviewee 2	Fried Chicken Seller	Micro	Yes	0-50 Million Rupiah	Bengkulu Province
3	Interviewee 3	Consultant	Small	Yes	50-250 Million Rupiah	East Java Province
4	Interviewee 4	Entrepreneur (Unwilling to mention)	Micro	Yes	0-50 Million Rupiah	Lampung Province
5	Interviewee 5	Sports training service provider	Micro	No (non-effective/deleted)	0-50 Million Rupiah	DKI Jakarta
6	Interviewee 6	Financial Consultant and Used car seller	Small	Yes	50-250 Million Rupiah	Bengkulu Province
7	Interviewee 7	Food Distributor	Small	No (not registered)	50-250 Million Rupiah	Bengkulu Province
8	Interviewee 8	Photographer on call	Micro	No (not registered)	0-50 Million Rupiah	Bengkulu Province
9	Interviewee 9	Car Wash	Small	Yes	50-250 Million Rupiah	Riau Islands Province
10	Interviewee 10	Tutoring service provider	Micro	No (not registered)	0-50 Million Rupiah	Bengkulu Province
11	Interviewee 11	Business-related legal consulting service provider	Small	Yes	50-250 Million Rupiah	Bali Province
12	Interviewee 12	Painting and Bonsai seller	Small	Yes	50-250 Million Rupiah	Bali Province
13	Interviewee 13	Cafe owner	Micro	Yes	0-50 Million Rupiah	West Java Province
14	Interviewee 14	Shoe washing service	Micro	Yes	0-50 Million Rupiah	Bengkulu Province

## **Annex B**

### **Questions for Survey**

1. Name/Alias
2. Age
3. Province of residence
4. Type of work: 1) businessman, 2) employee, 3) self-employed
5. How much do you and your spouse (if any) earn for one year: 0-50 million Rupiah, 2) 50-250 million Rupiah, 3) 250-500 million Rupiah, 4) more than 500 million Rupiah
6. Have you registered yourself at the tax office? 1) yes, 2) No.
7. If not registered yet, why not? 1) not necessary yet, 2) Didn't know there are rules that require to have a NPWP 3) other reasons
8. If registered, since when?
9. If you are registered at the tax office and have a NPWP, how much tax do you pay for one month?
10. With the taxes you pay, are you satisfied with the facilities that the government currently provides?
11. based on the public facilities that you currently enjoy, how much tax (in your opinion) should you pay each month?
12. Are you willing to be interviewed if additional information is needed? 1) yes, 2) no
13. If you are willing to be interviewed, can you include a telephone number (which is connected to WhatsApp) and an email that I can contact?

### **Likert Scale (Strongly Disagree to Strongly Agree)**

The following are questions related to moral variables. The following questions will measure your attitude which is described in moral (intrinsic motivation) towards your level of tax compliance

1. I pay taxes because I am a person who wants to contribute to the country (Strongly disagree, disagree, neutral, agree, strongly disagree)
2. I pay taxes because I want to be a good citizen (Strongly disagree, disagree, neutral, agree, strongly disagree)
3. I enjoy paying taxes (Strongly disagree, disagree, neutral, agree, strongly disagree)
4. I feel ashamed if I don't do my tax obligations well (Strongly disagree, disagree, neutral, agree, strongly disagree)
5. Based on your current internal motivation, how do you measure your tax compliance level? (Open-ended question)

The following are questions related to fiscal contract variables. The following questions will measure your attitude which is described in fiscal contract towards your level of tax compliance

6. Based on the taxes that I paid, I am satisfied with the public goods and services provided by the government (Strongly disagree, disagree, neutral, agree, strongly disagree)

7. Good public facilities and services can make people comply to tax rules (Strongly disagree, disagree, neutral, agree, strongly disagree)
8. Poor facilities and services will make people reluctant to pay taxes (Strongly disagree, disagree, neutral, agree, strongly disagree)
9. How would you rate the government facilities and services you currently receive? Relate this with the amount of taxes you have paid so far. (Open ended questions)

The following are questions related to complexity of tax laws variables. The following questions will measure your attitude which is described in level of understanding of tax laws towards your level of tax compliance

10. Simple tax rules will make people more comply and obedient to the tax rules (Strongly disagree, disagree, neutral, agree, strongly disagree)
11. Current tax rules are simple (Strongly disagree, disagree, neutral, agree, strongly disagree)
12. I am actively updating my knowledge on the latest tax regulations (Strongly disagree, disagree, neutral, agree, strongly disagree)
13. How would you rate your knowledge towards tax system in Indonesia and relate that with your fulfillment of your tax obligation so far. (Open ended question)

The following are questions related to relationships with tax officer variables. The following questions will measure your attitude which is described in your relationships with tax officer towards your level of tax compliance

14. Friendly tax officers make people more comply with tax regulations (Strongly disagree, disagree, neutral, agree, strongly disagree)
15. Tax officers who actively approach taxpayers will make them comply with tax regulations (Strongly disagree, disagree, neutral, agree, strongly disagree)
16. tax officers who are strict, have constant suspicious, and often threaten to do audit make taxpayers comply with the tax system (Strongly disagree, disagree, neutral, agree, strongly disagree)
17. In my opinion, the good relationship that exists between tax officers and taxpayers can improve tax compliance even without any punitive action (Strongly disagree, disagree, neutral, agree, strongly disagree)
18. Which do you think is the most effective, friendly attitude or fierce attitude, in increasing taxpayer tax compliance. relate to your experience (open ended question)

The following are questions related to fairness. The following questions will measure your attitude which is described in your sensitivity to the tax rules that apply to you towards your level of tax compliance

19. Based on your understanding, how you describe fair tax system (open ended question)

## Annex C

### Questions for Semi Structured Interview

I am a student who currently studying at the International Institute of Social Studies of Erasmus University Rotterdam majoring in Governance and Development Policy (GDP). I am currently researching the perception of individual taxpayers on tax compliance by referring to psychological factors. There are five interviewees who are expected to participate in this interview, and you are one of them. I am committed to keeping all identities and answers provided during this interview process as good as possible and guarantees to use them for academic purposes only. I will also ensure that all the data obtained in your answer which is then processed in this research cannot be traced back to you. This interview is completely voluntary, and you are allowed to stop whenever you wish. If there are questions that you are not comfortable to answer, you are allowed to not answer them at all. In total, the interview will take a maximum of 30 minutes. Are you willing to stay for the interview?

are you give your permission to be recorded?

1. In your opinion, what percentage of taxes contribute to the state revenues?
2. According to your own understanding, what is a tax?
3. Are there any direct benefits that you feel from paying taxes?
4. In your own opinion, how do you assess your level of tax compliance?
5. If you think you are someone who complies with taxation, what motivates you to comply with the tax system? (And vice versa, depending on the answer to the previous question)
6. Based on the amount of tax that you have paid so far, in your opinion, are you satisfied with the public goods and services that the government has provided at this time?
7. If the public facilities in the area where you live are updated and added by the government, will you pay much higher taxes than what you pay now?
8. If so, on what percentage you willing to add? (From 1 to 5%)
9. Did you know that there are special tax rules specifically designed by the government for MSMEs?
10. Have you ever updated your knowledge on the latest tax rules? (Independently, without the intervention of tax officer)
11. Have you ever been to the tax office and interacted with the employees there? How would you rate your relationship with the tax officer?
12. The treatment you received from the tax office made you more obedient or not?
13. In your opinion, what is fair tax system?
14. How would you rate the fairness of current tax system?
15. If someone you really respect (religious leaders, traditional leaders, family, etc.) tells you to pay taxes properly and correctly, will you comply?