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Taxpayer Compliance, Trust, and Power

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Abstract

Self-assessment system as adopted in Indonesia, focusing on taxpayer awareness. Therefore trust should be the spearhead of tax compliance rather than power. This study aims to examine how trust and power play a role in improving tax compliance by the slippery slope framework. Method of data collection in this research surveys in Central Java. The sampling technique is a multi-stage sampling that combines stratified random sampling and convenience sampling. Data has been collected from October 2015-April 2016, and 242 instruments were collected (86.4 percent response rate). By using multiple regression tests, the results of this study indicate that trust and power both simultaneously and partially affect tax compliance. Based on the coefficient different test, power has a greater impact than trust in creating tax compliance. This means that the compliance created in Indonesia is mandatory compliance that denies from self-assessment system that based on voluntary compliance.

Keywords: Power; Taxpayer Compliance; Trust

JEL Classification: H26; G41

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Abstrak

Self-assessment system *seperti yang dianut di Indonesia, menitikberatkan pada kesadaran wajib pajak. Oleh sebab itu seharusnya kepercayaan menjadi ujung tombak kepatuhan pajak bukan kekuasaan. Penelitian ini menguji bagaimana kepercayaan dan kekuasaan berperan dalam meningkatkan kepatuhan pajak sesuai dengan kerangka kerja* slippery slope. *Metode pengumpulan data dalam penelitian ini adalah survei di Jawa Tengah sebagai responden. Teknik pengambilan sampel adalah* multi-stage sampling *yaitu menggabungkan* stratified random sampling *dan* convenience sampling. *Data dikumpulkan pada Oktober 2015–April 2016 dan terkumpul 242 data (tingkat respon rate 86.4%). Dengan menggunakan uji regresi berganda dan uji beda koefisien, hasil penelitian ini menunjukkan bahwa kepercayaan dan kekuasaan baik secara simultan maupun parsial berpengaruh terhadap kepatuhan pajak. Berdasarkan uji beda koefisien, power ternyata memiliki pengaruh yang lebih besar dibandingkan trust dalam menciptakan kepatuhan pajak. Hal ini berarti bahwa kepatuhan yang tercipta di Indonesia adalah* mandatory compliance *yang mengingkari* self-assessment system *yang dilandaskan pada* voluntary compliance.

Kata Kunci:*Kekuasaan; Kepatuhan Pajak; Kepercayaan*

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Indonesia has implemented the self-assessment system for its tax collection purpose. It is expected that the self-assessment system will increase tax revenue because the system fully relies on taxpayers' willingness to actively fulfill their tax obligation (voluntary compliance) (Damayanti, 2012). The trust in taxpayers' awareness likely encourages taxpayers to comply more with tax regulations and to fulfill their tax obligations actively. However, the World Bank data (2014) shows that the Indonesian tax ratio in 2014 was only 31.4 percent. This figure was lower than other countries' ratios, such as Malaysia (39.8 percent), Japan (51.3 percent), and India (61.7 percent).

Several studies have analyzed factors that increase tax revenue, including the economic factors such as the probability of being audited and tax sanction. However, these studies show different results of the association between the probability of being audited, sanctions, and tax compliance (Ebimobowei, 2013; Prince, 2014; Gunarso, 2016). Alm (1991) highlights this difference by arguing that these economic factors are less likely to affect tax compliance. Because the economic factors do not necessarily increase tax compliance, it is important to investigate the effects of the non-economic factors on tax compliance.

Several non-economic factors are the psychological factors that are considered to be more appropriate in the tax compliance literature because in a democratic country like Indonesia, the relationship between tax authorities and taxpayers is a psychological one (Jayawardane, 2015). The psychological factors that can be used to analyze tax compliance are trust in tax authorities and tax authorities' power. In the slippery slope framework, Wahl, Kastlunger, & Kirchler (2010) suggest that tax authorities can increase tax compliance by enhancing trust in tax authorities and tax authorities' power.

Several studies have analyzed the relationship between trust and tax compliance (Richardson, 2008; Hammar, Jagers, & Nordblom, 2009; Dijke & Verboon, 2010; Birskyte, 2015; Gangl, Hofmann, & Kirchler, 2015) and indicated that trust affects tax compliance. These studies partially test the effects of trust and power on tax compliance. However, Kogler et al. (2013) and Muehlbacher, Korgler, & Kirchler (2011) simultaneously test trust and power by using the slippery slope framework.

In the taxation literature, a slippery slope framework is an approach that aims to integrate the economic and psychological factors to explain tax compliance (Wahl, Kastlunger, & Kirchler, 2010; Kohler et al., 2013; Mas'ud, Manaf, & Sa'ad, 2015). Scholars use the psychological factors in their analysis because previous literature does not consistently show the effects of the economic factors such as the probability of being audited and fines on tax compliance. These inconsistent results potentially invalidate the argument that taxpayers aim to avoid taxes (Kirchler et al., 2010).

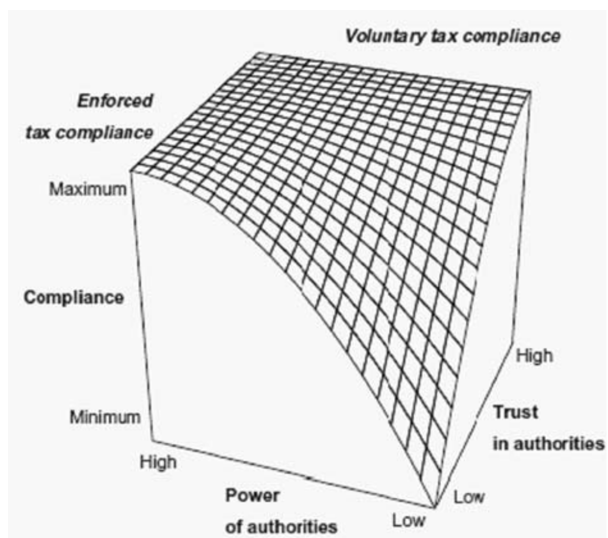

Figure 1. Slippery Slope Framework
Source: Tsikas (2017)

Slippery slope theory is a theory that consists of two dimensions, namely authorities' power and trust in authorities (Kirchler, Hoelzl, & Wahl, 2008). Further, Wahl, Kastlunger, & Kirchler (2010) and

Kogler, Muehlbacher, & Kirchler (2013) suggest that authorities' power and trust in authorities affect tax compliance. More specifically, when authorities' power and trust in authorities are low, tax compliance will also be low because taxpayers will act rationally by avoiding taxes and maximizing their profits. On the other hand, when power and trust increase, tax compliance will also likely increase.

Trust is defined as the general opinion that tax authorities exhibit good behavior and work for the common interests. Kirchler, Hoelzl, & Wahl(2008) define trust as groups or individuals who perceive that tax authorities perform their duties well for the common interests. Trust can be explained as the specific quality in the relationship or interaction between authorities and their partners in which they perceive each other positively and are motivated to maintain the relationship (Hoffmann et al., 2014). If tax authorities treat taxpayers as partners by acting honestly, fairly, informatively, and beneficially then taxpayers' compliance will increase.

Besides trust, power is another dimension of the slippery slope. Power is defined as the capacity to detect and punish tax offenders (Kirchler, Hoelzl, & Wahl, 2008). Power refers to the perception of the ability of tax authorities to detect and punish tax offenders (Kirchler, Hoelzl, & Wahl, 2008). Power increases when tax authorities conduct a thorough tax investigation and punish tax offenders. Ratmono & Cahyonowati (2013) and Modugu & Anyaduba (2014) conclude that taxpayers' compliance tends to increase when the likelihood of being investigated by tax officials and being fined if not complying is significantly high.

Based on the framework, increasing trust in tax authorities and enhancing taxpayers' perception of tax authorities' power will potentially increase tax compliance. According to Kogler et al. (2013), trust in tax authorities and tax authorities' power enhance tax compliance, but with different magnitude. Trust will lead to voluntary compliance while increased authorities' power increases enforced compliance. High level of trust in authorities combined with high authorities' power will likely result in the greatest tax compliance (Mas'ud, Manaf, & Sa'ad, 2015).

As a taxation system that depends heavily on taxpayers' awareness, the self-assessment system is supposed to rely more on trust than on power in enhancing tax compliance. However, the Indonesian tax culture that relies on sanctions (Doran, 2009; Poppelwell, Kelly, & Wang, 2012; Savitri & Musfialdy, 2016) is not in line with the initial objective of the implementation of the self-assessment system that encourages taxpayers to fulfill their tax obligations voluntarily (voluntary compliance) but emphasizes more on enforced compliance. Voluntary compliance is closely related to the commitment that describes that taxpayers exhibit moral obligation to pay taxes and to act for the benefits of their fellow citizens (Braithwaite, 2003) so that taxpayers comply without coercion (Jayawardane, 2015). Meanwhile, enforced compliance refers to resisting attitudes (Jayawardane, 2015). The resistance emerges when ones feel coerced so that they refuse to comply. In the taxation context, the resistance exists when taxpayers perceive that tax authorities do not sufficiently monitor their tax compliance that reduces the likelihood of being detected (Kramer, 1999). Thus, it is necessary to reevaluate whether the trust is the main determinant of tax compliance in the Indonesian self-assessment system.

Previous studies mainly investigate whether trust and power and the interaction between these two variables affect tax compliance. However, these studies have not analyzed whether trust or power dominates in explaining tax compliance. Consequently, this study aims to test the effects of trust and power on tax compliance and whether trust or power is more dominant in affecting tax compliance. This study uses taxpayers in Central Java Province as the respondents because this province has the tax compliance ratio of 57% (Ellya, 2016) that is lower than the national tax compliance ratio of 63.15%. This relatively higher tax compliance ratio indicates that Central Java has issues about tax compliance.

HYPOTHESES DEVELOPMENT

The slippery slope framework assumes that trust in tax authorities and power affects taxpayers' compliance (Kirchler, Hoelzl, & Wahl, 2008; Prinz, Muehlbacher, & Kirchler, 2014). Trust is taxpayers' perception that tax authorities are trustworthy and fair in administering tax revenue. Meanwhile, power is a perception that tax authorities are capable of monitoring tax system and giving sanctions to non-compliant taxpayers. Consequently, increasing trust in tax authorities and tax authorities' power will lead to tax compliance (Kogler et al., 2013).

Indonesia has implemented the self-assessment system since 1983, giving taxpayers' awareness of an important role in increasing tax compliance. Taxpayers' trust in tax authorities likely increases tax awareness. On the other hand, the official assessment system in tax administration emphasizes power in creating tax compliance. Thus, trust plays a more important role than power in the self-assessment system. Based on the theoretical and empirical arguments, we propose the following hypotheses:

H_1: trust in tax authorities and tax authorities' power increase business owners' tax compliance

H_2: trust in tax authorities is more influential than tax authorities' power in increasing business owners' tax compliance

METHODS

Our population was all business owners in the Central Java Province who also directly managed the business. We selected business owners who also managed their businesses as our sample because they were more likely to perform all tax functions (Damayanti, 2012) and to avoid tax (Wahl, Kastlunger, & Kirchler, 2010). However, the number of business owners as our population was not exactly known.

We relied on the multi-stage sampling by using the stratified random sampling and convenience sampling. We used stratified random sampling to determine sample cities and regencies based on the tax ratio of cities and regencies in Central Java Province. We stratified cities/ regencies based on the tax ratio to enhance the generalizability of our results because our sample represented each stratification.

We initially classified regencies and cities in Central Java Province based on the tax ratio data (Damayanti, Sutrisno, Subekti, & Baridwan, 2015). Based on the tax ratio, there were three categories of cities or regencies, namely high tax ratio, moderate tax ratio, and low tax ratio. We selected three cities/regencies for the high tax ratio and two cities/regencies for the other two categories, resulting in seven cities/regencies as the research location. These seven cities/regencies were Wonosobo Regency, Rembang Regency, Semarang City, Semarang Regency, Temanggung Regency, Surakarta City, and Salatiga City. To ensure data normality, we selected 30 samples for each city/ regency, resulting in 280 sample in total.

Based on the stratification process, we then selected our sample using the purposive sampling technique. Business owners had to qualify two conditions before being selected as the respondents. Firstly, business owners had to manage their firms directly. Secondly, business owners had to have their *NPWP* or Taxpayers Identification Number. We used these criteria because business owners who directly manage their firms are more likely to understand the tax trilogy, namely calculate, pay, and report. Next, we collected our research data by directly distributing the questionnaires to the respondents. Because we did not have the detailed data on business owners, we used the convenience sampling to select our sample.

We distributed the questionnaires to our respondents from October 2015 to April 2016. The questionnaire contained three variables, namely trust in tax authorities and power as the independent variables, and taxpayers' compliance as the dependent variable. Table 1 displays the empirical indicators.

We measured all variables, namely trust, power, and (voluntary and enforced) tax compliance using the Likert scale with five alternative answers ranging from 1 for "strongly disagree" and 5 for "strongly agree."

We initially ran the pilot test before distributing the questionnaire to our respondents to ensure that our respondents fully understand our questionnaire and provide data accordingly. We carried out the run test in Magelang City, a city that was not included as the research location. We then tested the validity and reliability of the pilot test data. The tests showed that items for each variable used to generate data were valid and reliable.

We empirically tested our first hypothesis by running the multiple regression test where the independent variables were trust and power and the dependent variable was taxpayer's compliance. To test whether the trust is more influential than power in explaining taxpayer's compliance, we ran the test of the coefficient difference using the t-test.

One can run the t-test for the coefficient difference only for different models. Thus we ran the univariate regression test to generate the regression coefficient. The following is the equation to test the coefficient difference using the t-test:

Table 1. The Empirical Indicators of the Research Variables

Variable	Indicator
Trust	a. In general, I fully trust in the tax authorities' decisions. b. I am usually happy with the way the tax authorities solve taxpayers' tax-related problems. c. In general, I appreciate most of the tax authorities. d. Tax authorities often do not know their main tasks. e. I think I understand better what is the best for me and the business group than tax authorities f. Tax authorities usually understand what is the best for a group of business Source: Mulder, Verboon, & De Cremer(2009)
Power	a. Tax authorities have great power to coerce taxpayers to be honest about their tax obligation. b. Tax authorities manage to expose tax evasion because of their knowledge and authority. c. Tax authorities manage to combat tax evasion criminal act efficiently. Source: Muehlbacher, Kirchler, & Schwarzenberger(2011)
Tax Compliance	Voluntary compliance I pay taxes as stipulated by the acts…." a. Because I think I have to do it. b. To support the country and other fellow citizens. c. Because I want to contribute to the benefits of my country. d. Because it is natural for me to do it. e. Because I consider it to be my obligation as a citizen. Enforced compliance I pay taxes as stipulated by the acts…." a. Because there are frequent tax investigations. b. Because of harsh punishment for those who commit tax evasion. Because I don't know exactly evade taxes without raising attention from the tax authorities.

Source: Wahl, Kastlunger, & Kirchler (2010)

$$t = \frac{\beta 1 - \beta 2}{\sqrt{\frac{SSE\,(1)+SSE\,(2)}{df\,(1)+df\,(2)} \blacksquare \left[\frac{(\beta 1)^2 \times (df\,(1))}{(t(1)^2 \times (SSE\,(1))}+\frac{(\beta 2)^2 \times (df\,(2))}{(t(2)^2 \times (SSE\,(2))}\right]}} \ldots\ldots\ldots. (1)$$

Notation:

β_1, β_2 = Coefisien

SSE = Sum of Square Error

Df = degree of freedom

By using the following hypothesis:

H_{02}: trust in tax authorities and tax authorities' power has no different effects on business owners' tax compliance

H_2: trust in tax authorities has a greater influence on business owners' tax compliance than tax authorities' power

The criteria for the t-test is if t_{score}<1.960 then H_0 is accepted and Ha is rejected, implying that trust in tax authorities and tax authorities' power have equal effects on business owners' tax compliance. On the contrary, if t_{score}>1.960 then H_0 is rejected, and Ha is supported, suggesting that trust in tax authorities has a greater effect on business owners' tax compliance than tax authorities' power.

RESULTS

We distributed 40 questionnaires for each city/regency selected as research locations, resulting in 280 total questionnaires and 242 usable questionnaires (response rate of 86.4 percent). Table 2 below explains the details of the questionnaire distribution.

Table 2. Distributed, Returning, and Usable Questionnaires

Explanation	Amount	Percentage
Distributed Questionnaires	280	100
Non-returning Questionnaires	14	5
Returning Questionnaires	24	8.6
Usable Questionnaires	242	86.4

Based on Table 2, from 242 final respondents, 144 of them are male, and there are 98 female respondents. Most respondents (68 percent) have a senior high school education level while the rest (32 percent) have a bachelor degree. Meanwhile, all respondents have Taxpayer Identification Number (*NPWP – Nomor Pokok Wajib Pajak*). Further, most respondents started their businesses started between 2006 and 2010 (60.83 percent) and their businesses have a gross monthly turnover of between three million rupiahs and 400 million rupiahs. The respondents' characteristics show that our respondents exhibit sufficient tax awareness and knowledge as indicated by the fact that all respondents already have their *NPWP*. Besides, most of the respondents' businesses are almost ten years old, thus indicating that respondents have carried out their tax function for a sufficiently long time.

Table 3. Descriptive Statistics

Variable	Min	Max	Average
Trust	1	5	3.60
Power	1	5	3.98
Kepatuhan Pajak	1	5	4.03

Table 3 displays the maximum, minimum, and average values of all variables. In general, respondent's exhibit relatively high scores of all variables (trust, power, and tax compliance) as indicated by the fact that the average values of these variables are above three. More specifically, respondents trust in tax authorities and perceive that tax authorities have a great taxation power. Lastly, respondents also exhibit high tax compliance.

To test our hypotheses, we tested the simultaneous effects of the independent variables on the dependent variable by running the multiple regression equation. Table 4 demonstrates that the R^2 value is 0.421 or 42.1 percent, implying that all the independent variables explain 42.1 percent of the variation of the dependent variable while other unspecified variables explain 57.9 percent of the variation. Table 4 also shows the significance value of 0.000

(<0.05), suggesting that all the independent variables (trust and power) simultaneously have significant effects on tax compliance.

Table 4. Hypothesis Testing

Variable	Coefficient Value	Sig
Constant	12.520	0.000
Trust	2.801	0.065**
Power	3.461	0.022*
R^2		0.421

Exp: *, **=significant at a 5 percent, 10 percent, respectively

Table 4 above informs that the coefficient value of the trust variable is 2.801 with a positive sign, suggesting that higher respondents' trust in tax authorities increases their tax compliance. Meanwhile, the regression coefficient of the power variable is 3.461 with a positive sign. This result indicates that when taxpayers perceive tax authorities have greater taxation power, they will exhibit greater tax compliance. Table 4 also shows that the significance value of the trust variable is 0.065 (<0.10), implying that trust significantly affects tax compliance. Further, the significance value of the power variable is 0.220. This result indicates that power significantly affects tax compliance.

In testing the second hypothesis, our results show that the coefficient value of power (3.461) is greater than the coefficient value of the trust (2.801). Further, the test of coefficient difference as in the equation (1) demonstrates the t-value of 2.010 or greater than 1.960. These findings suggest that the power variable has a greater effect on tax compliance than the trust variable.

DISCUSSION

The empirical test demonstrates that the trust and power variables simultaneously affect business owners' tax compliance. In a similar vein, the partial test shows that both trust and power significantly affect tax compliance. These results support the slippery slope framework that suggests that trust and power affect tax compliance.

These findings also imply that taxpayers' trust in the taxation system leads them to comply with the tax regulations. Further, our results support Richardson (2008), Hammar, Jagers, & Nordblom (2009), Dijke & Verboon (2010), Birskyte (2015), and Gangl, Hofmann, & Kirchler (2015). The importance of trust in affecting tax compliance does not only refer to business owners' trust in tax authorities but also to taxpayers' perception that tax authorities trust in them in fulfilling their tax obligation.

The power variable also significantly affects tax compliance. Consequently, taxpayers' perception of the government's power affects tax compliance. These findings support Doran (2009), Kirchler et al. (2010), and Hoffmann et al. (2014).

Our second hypothesis predicts that trust in the self-assessment system has a more dominant effect on tax compliance than the power variable. However, our coefficient difference test as shown in the equation (1) indicates that power is more dominant in affecting tax compliance than the trust variable. These findings suggest that tax compliance is mainly driven by taxpayers' perception that the tax authorities have a great taxation power. Taxpayers consider the tax authorities to have a greater power to coerce them to fulfill their tax obligation honestly, to be able to uncover tax avoidance and to prevent tax evasion efficiently due to their knowledge and authority. This perception greatly drives taxpayers to comply with their tax obligation. Further, these findings also suggest that taxpayers exhibit the mandatory compliance, thus contradicting the essence of the assessment system that mainly relies on taxpayers' voluntary compliance.

CONCLUSION AND SUGGESTIONS

Conclusion

Our empirical results suggest that trust and power, either simultaneously or partially, positively affect business owners' tax compliance. However, power has a greater effect on tax compliance than trust. Overall, these findings indicate that taxpayers tend to exhibit the mandatory compliance.

Suggestions

Our study demonstrates that trust and power are important in affecting tax compliance of business owners in Central Java. However, enhancing taxpayers' trust in tax authorities and perception that tax authorities trust in them in fulfilling their tax obligation is better than increasing tax authorities' power. Consequently, it is necessary for tax authorities to increase their service quality to increase business owners' trust. Besides, tax authorities also need to trust more in taxpayers so that taxpayers will comply more with their tax obligation.

This study is subject to the following caveats. Firstly, our study does not focus on businesses in specific ages or revenue levels. Consequently, our data varies greatly and our results are less generalizable to all respondents. We thus advise that further studies extend the analysis by investigating the effect of firm age on tax compliance. Secondly, our respondents exhibit greater variance in their educational levels (from junior high school to a bachelor degree), implying that the results may differ if we focus on respondents with specific educational level. Lastly, sample size bias also limits the generalizability of our study.

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