

The Effect of Tax Fairness on Tax Compliance With Trust as an Intervening Variable

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Abstract

The purpose of this study is to provide empirical evidence about the effect of tax fairness on tax compliance with trust to tax authority as an intervening variable. 300 questionnaires were distributed, 195 were returned for a response rate of 65 percent. The Partial Least Squares (PLS) approach is used to test the hypotheses developed in this study. SmartPLS software is used for this study. This study reveals four important findings: (1) tax fairness has a significant positive effect on tax compliance, (2) tax fairness has a significant positive effect on trust, (3) trust has a significant positive effect on tax compliance, (4) trust mediates the relationship between tax fairness and tax compliance. This research not only has implications on practice but also to the literature concerning the effect of tax fairness and trust on tax compliance. It is also expected that this research provides valuable information for the government to create a fair tax system.

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Abstraks

Tujuan dari penelitian ini adalah untuk memberikan bukti empiris tentang pengaruh keadilan pajak terhadap kepatuhan pajak dengan kepercayaan terhadap otoritas pajak sebagai variabel intervening. 300 kuesioner yang dibagikan, 195 dikembalikan dengan tingkat respons 65 persen. Pendekatan Partial Least Squares (PLS) digunakan untuk menguji hipotesis yang dikembangkan dalam penelitian ini. Perangkat lunak SmartPLS digunakan untuk penelitian ini. Studi ini mengungkapkan empat temuan penting: (1) kewajaran pajak berpengaruh positif signifikan terhadap kepatuhan pajak, (2) kewajaran pajak berpengaruh positif signifikan terhadap kepercayaan, (3) kepercayaan memiliki positif signifikan efek pada kepatuhan pajak, (4) kepercayaan memediasi hubungan antara keadilan pajak dan kepatuhan pajak. Penelitian ini tidak hanya memiliki implikasi pada praktik tetapi juga untuk literatur tentang efek keadilan pajak dan kepercayaan pada kepatuhan pajak. Diharapkan juga bahwa penelitian ini memberikan informasi yang berharga bagi pemerintah untuk menciptakan sistem pajak yang adil.

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1. INTRODUCTION

Tax is Indonesia's largest source of revenue. Tax distribution is pursued to the maximum extent possible for the welfare of the people as stated in the Act (Act) General provisions on taxation article

1 of Law No. 28 of 2007. The law states that tax is a compulsory contribution to the state by an individual or a compelling entity based on the Act, by not getting rewards directly and being used for the purposes of the country and as much as possible

for the prosperity of the people. Indonesia since 1983 has implemented a self-assessment system. In this system, taxpayers have an obligation to calculate, deposit and report their own tax obligations to the Tax Service Office. This shows that the government has entrusted the taxpayers to fulfill their obligations with responsibility.

The application of a self-assessment system will be effective if voluntary compliance in the community has been achieved so that the act of coercion in carrying out its obligations is not necessary (Damayanti et al., 2015). A condition of voluntary compliance in fulfilling tax obligations will be achieved if the Taxpayer knows that government revenues obtained from taxes are used for national

development. Currently, the tax compliance rate in Indonesia is still relatively low, and the tax revenue target is always lower than the realization of tax revenue. Table 1 shows that for nine years Indonesian tax revenues have never reached a predetermined target, this indicates that the level of taxpayer compliance is still low. Indonesia has around 180 million potential taxpayers but only 28 million who are registered with just 10 million who comply to pay tax regularly. Furthermore, The proportion of Indonesia's tax revenue per GDP is less than 12.75% and remain the lowest in Southeast Asia. Thailand records 17% of tax ratio, Malaysia is 15.5%, the Philippines is 14.4%, Singapore is 14.2%, and Vietnam is 13.8% (Verico, 2018).

Table 1. Target and Realization of Tax Revenue Indonesia Period 2009-2017

Year	Tax revenue target (trillion rupiahs)	Realization of Tax Revenues (trillion rupiahs)	Percentage of realization of Tax revenue on Target (%)
2009	577	545	94.5%
2010	662	628	94.9%
2011	764	743	97.3%
2012	836	885	94.5%
2013	995	921	92.6%
2014	1.072	985	91.9%
2015	1.294	1.055	81.5%
2016	1.355	1.105	81.54
2017	1.283	1.151	89.68

Source: Directorate General of Taxes.

Compliance in paying taxes can be influenced by several factors, one of which is tax fairness. Fairness is one component of a good tax system (Tan & Chin-Fatt, 2000). Fairness plays an important role in the behavior of taxpayers in reporting taxes (Hartner et al., 2008). Richardson (2006) states that the key to tax compliance behavior is tax fairness. Taxpayers will have a tendency to avoid paying taxes if the tax system is considered unfair. The majority of previous studies examining the effect of tax justice on compliance show consistent results that tax fairness has a positive impact on voluntary compliance (Tan & Chin-Fatt, 2000; Gilligan & Richardson, 2005; Hartner et al., 2008; Khasawneh et al., 2008 ; Saad, 2012; Siahaan, 2012; Asnawi, 2013; Geberegbe et al., 2015; Faizal & Palil, 2015; Jimenez & Iyer, 2016; Azmi et al., 2016).

Besides tax justice, another variable that can affect tax compliance is trust. Robbins (2001) states that trust is a positive expectation that other people will not act opportunistically through words, actions, or decisions. If the taxpayer has confidence in the tax institution, the taxpayer will voluntarily carry out his obligation because he feels confident that his rights and interests will not be misused (Siahaan, 2012). Several prior studies have investi-

gated the influence of trust on compliance behavior (Faizal et al., 2015, Damayanti et al., 2015; Siahaan, 2012; Muehlbacher & Kirchler, 2010), and they find that tax justice affects compliance. Furthermore, Faizal et al. (2015) and Siahaan, (2012) use trust as a variable that can mediate the relationship between fairness and taxpayer compliance, but both researchers produce inconsistent findings. Siahaan (2012) and Gobena Dijke (2016) found that justice affects mandatory compliance through trust, whereas Faizal et al. (2015) found that trust does not mediate the relationship between tax fairness and compliance.

This study will examine the effect of tax fairness on compliance with trust in the tax authorities as an intervening variable. There are two reasons that motivate researchers to conduct this research. First, the inconsistency of the results of previous studies related to trust as an intervening variable. Second the lack of prior research that examines the relationship between tax fairness, trust, and compliance (Siahaan, 2012; Gobena Dijke, 2016; Faizal et al., 2015).

2. HYPOTHESIS DEVELOPMENT

Direct Influence of Tax Fairness on Taxpayer Compliance.

The role of tax justice perception in influencing tax compliance behavior has been widely studied by previous researchers. Murphy and Tyler (2008) state that if taxpayers are treated well and fairly by the tax authorities, then they will be more inclined to comply with applicable tax regulations. Verbon (2009) states that in order to increase tax compliance among entrepreneurs, the government must ensure that the prevailing tax system is fair. According to Nicoleta (2011), the perception of an unfair tax burden can affect taxpayer perceptions and can subsequently affect their compliance. Upstream research shows that tax justice has a positive and significant impact on taxpayer compliance (Tan & Chin-Fatt, 2000; Gilligan & Richardson, 2005; Hartner et al., 2008; Khasawneh et al., 2008; Saad, 2012; Siahaan, 2012; Geberegbe et al., 2015; Faizal & Palil, 2015; Jimenez & Iyer, 2016; Azmi et al., 2016). Based on the explanation, the following hypotheses can be formulated:

H₁: Tax fairness has a positive effect on tax compliance.

The Indirect Effect of Tax Justice on Compliance through Trust in Tax Authority

The importance of fairness in relation to taxpayers' trust is getting more attention from researchers. For example, Levi (1998) argues that the key to creating trust is to act fairly against taxpayers. If the individual feels that the tax authorities have carried out a fair procedure, then that person will be more confident in the tax authority (Murphy, 2004). Justice influences the taxpayer's acceptance of decisions made by the tax authorities and builds trust between taxpayers and these authorities (Murphy, 2004). Previous research shows that tax justice increases tax authority trust (Damayanti et al., 2015; Siahaan, 2012; Muehlbacher & Kirchler, 2010)

Furthermore, previous research also emphasizes that trust plays an important role in creating taxpayer compliance. Fair treatment received by taxpayers will increase taxpayer trust in the tax authorities and create high tax compliance. Rudolph (2009) argues that when taxpayers assume that the government can be trusted, they will support the actions taken by the government. Previous research (Wahl et al., 2010; Muehlbacher et al., 2011; Kogler et al., 2013) examined the effect of trust on compliance, and they found that trust had a posi-

tive and significant effect on compliance. Tax authorities that can be trusted can improve taxpayer compliance, namely voluntary compliance and compliance through law enforcement.

Some researchers used the slippery slope framework initiated by Kirchler (2007) and Kirchler et al. (2008). The Framework emphasizes that the compliance of citizens in paying taxes depends on the power of the tax authorities in enforcing compliance and trust in the tax authorities. Several previous research has conducted empirical research to test the slippery slope framework, The present findings are consistent with the assumptions of the slippery slope framework and confirm the role of trust and power as important determinants of tax compliance. For example, Wahl et al. (2010) conducted an experimental study to examine the motivation of taxpayers in complying with tax regulations in the slippery slope framework. Findings of Wahl et al. (2010) show that high trust and power increase compliance compared to low trust and power. High trust is perceived by respondents as voluntary compliance. Kogler et al. (2013) support the findings of Wahl et al. (2010) which found that participants in conditions of high trust indicate more voluntary compliance just as participants in conditions of high power indicate higher enforced compliance. Based on the explanation, the following hypothesis can be formulated:

H₂: Tax fairness has a positive effect on trust influences trust.

H₃: Trust has a positive effect on taxpayer compliance.

H₄: Trust mediates the relationship between tax fairness and tax compliance.

Based on the hypotheses development above, the research model can be formulated in the figure 1. Trust as an intervening variable to The Effect of Tax Fairness on Tax Compliance .

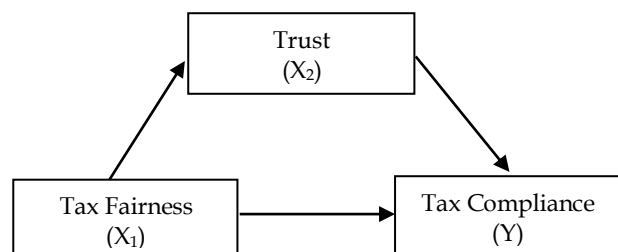


Figure 1. Research Model

3. DATA AND METHODS

This study uses a quantitative method research design with a causal relationship. This re-

search aim is to examine the causal relationship between variables studied through hypothesis testing. Primary data collection is done by using a questionnaire to taxpayers registered in the Tax Service Office in Kepanjen Malang Indonesia. The questionnaire consists of two parts. The respondents' profile was collected through the first part of the questionnaire. This section included five items: age, gender, level of education, average yearly income, and duration to become a taxpayer. The second part of the questionnaire is about variables under study, namely tax fairness, trust, and tax compliance. The sampling method used is accidental sampling. 300 questionnaires were distributed, 195 were returned for a response rate of 65 percent. The Partial Least Squares (PLS) approach is used to test the research model and hypotheses. SmartPLS software is used for this study.

Variable Measurement

The variables in this study were measured using a Likert scale with 5 (five) alternative answers, namely strongly agree, disagree, neutral, agree, strongly disagree.

Tax compliance

Taxpayer compliance is measured using an instrument from Siahaan (2012) consisting of 5 statements: taxpayers fill out the tax form correctly, completely and clearly; Taxpayers calculate their tax obligations correctly; taxpayers pay and report their taxes on time; taxpayers report their taxes on time. The Cronbach alpha for this measurement was 0.926626.

Tax fairness.

Tax fairness in this study was measured using modified measurements from Gruber, (2005), which included vertical equity and horizontal equity. The Cronbach alpha coefficient for this scale was 0,82 which indicated high internal reliability.

Trust.

Trust to the tax authority is the willingness of a citizen to be vulnerable to the actions of the government despite his/her inability to actively control the actions of the government. The scale to measure trust was based on the dimensions initiated by McAllister (1995), they are affect-based trust (attitude aspect) and cognitive-based trust (understanding aspect). The Cronbach alpha for this measurement was 0.92.

4. RESULT

Background of Respondents

Table 2 shows presents the demographic profile of 195 respondents involved in this study. As appears in Table 1 that 15.4 percent of the respondents were between the age of 0-30 years, 66 percent were between the age of 30- 39 years, 31.1 percent, 32.9 percent and 19.5 percents of the respondents were between the age of 40-49 years and over 50 years respectively. The number of female respondents (55.4 percent) is higher compared to male respondents, who comprise 44.6 percent. Considering the highest education, Table 2 also reveals 38.5 percent of the respondents graduated from elementary/secondary/ high school, 48.7 percent were diploma holders, 8.7 percent master/doctorate holders. Table 1 also shows that most of SMEs owners have an income per year below 50 million Indonesian Rupiah, and the remaining 28.7 percent 50-250 million Indonesian Rupiah. Based on Duration to become a taxpayer, 71,3 percent of respondents became taxpayers for 1-5 years, 27.7 percent for 6-10 years, and 1 percent for above 10 years. These percentages ratios indicate that most respondents are familiar with taxation issues, and they were subject to income tax for a long period of time.

Hypothesis Testing

Table 3 shows the output of the effect of tax Fairness on tax compliance with trust as an intervening variable using path analysis with smartpls program. As shown in Table 3 that the computed t-value equals to 4.890019, and t table is 1.972462. Based on the results, the t value higher than t table ($4.890019 > 1.972462$), and sig $0.000002 < 0.05$. The original sample estimate value is 0.355399 which indicates that the direction of the relationship between tax fairness and trust is positive. Based on the result, the hypothesis is supported. The higher the tax fairness, the higher trust to the tax authority. The results support the previous research conducted by Tan & Chin-Fatt (2000), Gilligan & Richardson (2005), Hartner et al., (2008), Khasawneh et al. (2008), Saad (2012), Siahaan (2012), Asnawi, (2013), Geberegbe et al. (2015), Faizal & Palil, (2015), Jimenez & Iyer (2016), Azmi et al. (2016).

Tabel 3 shows that t-value ($10.278562 > t$ -table (1.972462), and significant level is $0.000000 < 0.05$ ($\alpha = 5\%$). The value of the original sample estimate value is 0.619872 which indicates that the direction of the relationship between tax fairness and trust is positive. Thus the hypothesis 2 stating

that tax fairness has positive effects on trust is accepted. This means that tax fairness increases trust to tax authority. This result consistent with

prior studies (Damayanti et al., 2015; Siahaan, 2012; Muehlbacher & Kirchler, 2010)

Table 2. Respondent Profile

Variable	Frequency	Percentage (%)
Age		
- below 30 years	30	15.4
- 30-39 years	66	33.8
- 40-49 years	61	31.3
- 50 and above years	38	19.5
Gender		
- Male	87	44.6
- Female	108	55.4
Highest education		
- Elementary/ Secondary/ High School	75	38.5
- Diploma	95	48.7
- Bachelor	17	8.7
- Master/Doctorate	8	4.1
Income per year		
- below 50 million (Indonesian Rupiah)	139	71.3
- 50-250 million (Indonesian Rupiah)	56	28.7
Duration to become a taxpayer		
-1-5 years	101	71.3
- 6-10 years	53	27.7
- Above 10 years	41	1

Table 3 indicates that t value (5.691685) > t-table (1.972462) significant level is $0.000000 < 0.05$ ($\alpha = 5\%$). The value of the original sample estimate is 0.440260 which shows that the direction of the relationship between trust towards taxpayer compliance is positive. Thus, H_3 in this study was accepted. Tax authorities that can be trusted improve taxpayer compliance behavior. This finding support studies done by Wahl et al. (2010), Muehlbacher et al. (2011), Kogler et al. (2013).

As presented in Table 3, the effect of tax fairness on trust is significant with t-statistic (3.359786) > t-table (1.97623) and significance value of $0.00099 < 0.05$ ($\alpha = 5\%$). The table also indicates that the

effect of trust on tax compliance is significant as shown by t-statistic (2.027275) > t-table (1.97623) and significance value of $0.04444 < 0.05$ ($\alpha = 5\%$). Thus, the two paths are significant. Furthermore, the result of Sobel Test shows that the Sobel test statistic is 4.97946160 and one-tailed probability 0.00000032 which support the hypothesis that trust mediates the relationship between tax fairness and tax compliance. Therefore H_4 is accepted. The findings indicate that increased tax fairness can encourage greater trust to tax authority. Furthermore, the trust will ultimately enhance voluntary compliance.

Table 3. Path Coefficients (Mean, STDEV, T-Values)

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	t-statistics (O/STERR)	Sig.
Fairness → Compliance	0.355399	0.353801	0.072678	0.072678	4.890019	0.000002
Fairness → Trust	0.619872	0.630476	0.060307	0.060307	10.278562	0.000000
Trust → Compliance	0.440260	0.443812	0.077351	0.077351	5.691685	0.000000

t table : 1.972462

5. DISCUSSION

Tax fairness can affect tax compliance directly, or indirectly through the mediation of trust-in-tax authority. This result supports prior studies

which suggest that taxpayers will be more likely to comply when the tax system of a country is perceived to be fair (Tan & Chin-Fatt, 2000; Gilligan & Richardson, 2005; Hartner et al., 2008; Khasawneh et al., 2008; Saad, 2012; Geberegebe et al., 2015; Faizal

& Palil, 2015; Jimenez & Iyer, 2016; Azmi et al., 2016). Fairness is one of the attributes of a good tax system (Tan and Chin-Fatt, 2000) that plays an important role in tax reporting behaviour (Kim, 2002; Hartner, Rechberger, Kirchler and Scabmann, 2008, Razak and Adafula, 2013, Oberholzer and Stack, 2014, Damayanti et al., 2015). If a tax system is perceived to be unfair and inequitable, it can encourage taxpayers to evade tax payment and render the tax system less successful (Richardson, 2005).

In Indonesia context, studies on perception of fairness were done by Siahaan (2005; 2012), Asnawi (2013), and Damayanti et al., (2015). Taxpayer's perception of Indonesian government is important because the relationship between the taxpayer and the tax authority is a contract that involves an interaction between the taxpayer and the government in establishing a fair reciprocal relationship. The principle of fairness emphasizes that individuals must be taxed according to their ability and has been explained in terms of horizontal and vertical justice. In horizontal justice, individuals with the same income must be taxed at the same rate or be subject to the same tax liability. Vertical justice distinguishes individuals from different income positions.

For a tax system based on the concept of voluntary compliance to function effectively, taxpayers must have a positive perception of fairness. They must feel that, in the long run, they are getting their money's worth for the taxes they pay. There are three key aspects to process fairness in Indonesia. First, political processes give taxpayers an opportunity to influence how and to what extent they are taxed. Second, tax systems include safeguards that permit taxpayers to challenge the taxes assessed. Third, tax administrators are expected to treat taxpayers with respect.

The present study also shows that trust is a determinant of tax compliance behavior. The result is consistent with the notions of the slippery slope framework, which is proposed by Kirchler et al. (2008) and have been studied by previous research (Kastlunger et al., 2012; Siahaan, 2012; Kogler et al; 2012; Muehlbacher et al., 2011; Wahl et al., 2010).

Tax is the most important factor for Indonesia's finances to ensure the continuity of national development without depending on natural resources and foreign assistance. In Indonesia the tax function is a tool for carrying out the fifth principle in Pancasila, namely social fairness for all Indonesian people. Taxes will attract more money from rich people, which will be used for development

and provide subsidies so that less fortunate people can advance.

Tax fairness is the main substance in the formulation of tax policies, but fairness is an abstract and subjective matter, so it is very difficult to find a taxation system formula that can fulfill the principle of fairness. Indonesia uses a progressive tax rate, which is a tax collection rate with a percentage that increases with the increase in the amount of income taxed. The progressive tariff has indicated the concept of fairness, namely vertical fairness (unequal treatment for the unequals) and horizontal fairness (equal treatment for the equals). In vertical fairness, every Indonesian citizen is obliged to pay his tax according to his ability, based on the income they earn. The greater the ability to pay, the greater the tax charged to him. For example, for income tax, Indonesia has four tariff layers. For those who have an income of up to Rp 50 million per year, the tariff is 5%. While those who earn above Rp. 50 million, but under Rp. 250 million, the tariff is 15%. For those who earn more than Rp 250 million, but under Rp 500 million, the tariff is 25%. While the income rate above Rp. 500 million is 30%. Horizontal fairness in the tax perspective implies, for taxpayers with the same condition or ability to pay must be subject to the same amount of tax without distinguishing the type or source of income. taxpayers with a larger amount of income will bear a greater tax burden than taxpayers with a small income.

6. CONCLUSIONS AND SUGGESTION

Based on the results of the research and discussion above, some conclusions can be drawn as follows: (1) taxpayers would improve their tax compliance behavior if they perceived the tax authority manages to conduct good and fair treatment in tax activities, (2) Tax fairness perception will increase taxpayers' trust in the tax authority, and ultimately enhance tax compliance behavior. This suggests that tax fairness and trust perceptions are a crucial factor in fostering better voluntary compliance among taxpayers.

This research provides an essential contribution to the existing tax literature by establishing trust-in-tax authority as an intervening variable on the relationship between tax fairness and tax compliance. Theoretically, tax compliance can be achieved if a tax authority can be trusted and a government can provide a fair tax system. Besides that this study enriches empirical studies on the Slippery Slope Framework as proposed by Kirchler et al. (2008). A practical implication of this study is

for tax policymakers. Tax authorities should focus on introducing or developing tax rules that are fair to the taxpayers. Tax authorities could also enhance taxpayers' trust to foster better compliance. As explained above, tax revenues that cannot be achieved indicate high taxpayers' non-compliance. The results of this study indicate that trust should be considered when tax authority manages non-compliance behavior. If the authority is considered fair, people will trust the authority's motives and will obey their decisions voluntarily.

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