Determinants of the Tax Morale: Empirical Study on Micro, Small and Medium Enterprises in Java

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ABSTRACT

One of the reasons Indonesia's tax ratio has yet to reach its target is the informal sector and tax avoidance. The individual's desire to pay or avoid taxes is related to tax morals. This study aims to determine the effect of trust in the government, trust in tax administration, national pride, the likelihood of being caught in tax evasion efforts, and the level of punishment on tax morale. The research object is the owner of the micro, small, and medium enterprises (MSMEs) in Java. The research approach used is quantitative research. The data used are primary data consisting of 395 respondents' answers collected. Data analysis used the Ordinary Least Squares (OLS) method. The test results state that trust in the government, trust in tax administration, national pride, likelihood of being caught in tax evasion efforts, and the level of punishment simultaneously and partially have a significant positive effect on tax morale.

Keywords: tax morale, trust, national pride, likelihood of being caught, severity of punishment

1. INTRODUCTION

Indonesia's tax ratio has yet to be able to reach the target that has been set. The Ministry of Finance of the Republic of Indonesia, in the 2019 APBN outlook, has set Indonesia's tax ratio target of 11.1%. Meanwhile, according to the International Monetary Fund (IMF), a developing country like Indonesia should have a tax ratio of 15% in order to be able to finance its expenses (Gaspar et al., 2019). However, the realization of Indonesia's tax ratio only reached 10.7% in 2019 (Directorate General of Taxes, 2020).

The causes of Indonesia's low tax ratio, mentioned by the OECD in the 2019 Revenue Statistics in Asia and Pacific Economies report, are the informal sector and tax avoidance. Some large-scale companies legally enforce tax avoidance to avoid paying large amounts of tax. Small-scale companies also apply this practice. However, Mickiewicz et al. (2019) stated that companies with a smaller scale tend to reduce their tax obligations with a different strategy, namely committing tax evasion by engaging in the informal sector economy or not reporting all of their activities to the tax authorities.

In Indonesia, the participation of MSME actors in the tax amnesty program indicates that there are still business activities or income that still need to be reported to the Directorate General of Taxes. According to the 2017 annual report of the Directorate General of Taxes, the tax amnesty program was attended by 973,426 taxpayers, with details of 111,415 MSME Corporate Taxpayers (11.45%) and 322,189 MSME Individual Taxpayers

(33.10%). Comparing the number of MSMEs participating in the tax amnesty with the total MSMEs registered in Indonesia shows there is still potential for tax revenue from MSME activities.

Tax evasion is one of the challenges in the tax system adopted by Indonesia. The tax reform in 1983 introduced the tax system used in Indonesia, the self-assessment system. This system requires business actors to play an active role in fulfilling their tax obligations. According to Alm and McClellan (2012), a business's decision to pay taxes according to applicable regulations or evade taxes depends on the role and intentions of the business owner. That decision is also related to the motivation of the business owner. Individual intrinsic motivation to comply with and pay taxes is defined by Torgler and Schneider (2005) as tax morale. Lago-Peñas and Lago-Peñas (2010) revealed that business actors have lower tax morale than those who work as employees. In contrast, research by Blanthorne and Kaplan (2008) states that individuals with higher moral levels are less likely to evade taxes.

Many factors influence individual tax morale, but this study adopted the neo-institutional framework by Scott (2014), according to Mickiewicz et al. (2019), to explain how the environment affects the tax morale of business actors. This framework is still rarely used in tax moral research in Indonesia. The neo-institutional framework also provides a broad perspective on how institutions influence individual behavior. As stated by the pillars of regulation, institutions influence individual behavior through sanctions and normative judgments about how something should be done. Furthermore, institutions provide a cultural-cognitive pillar that assumes individuals adopt specific social identities. This identity defines their role in a group, limiting their behavior.

The normative pillar relates to the growing sense of trust resulting from the community's assessment or evaluation of an institution's duties and responsibilities. The cultural-cognitive pillar is related to the social identity held by the individual, which will later affect the individual's behavior. Some examples of social identity are nationalism and patriotism. Furthermore, the regulatory pillar is concerned with monitoring, sanctioning, and making rules that can influence an individual's decisions or behavior.

Most of the previous studies only discussed tax morale as an unknown cause of the emergence of tax evasion without considering how tax morale arose or was maintained (Feld & Frey, 2002). Based on this, this study aims to determine the effect of trust in the government and tax administration (normative pillar), national pride (cultural-cognitive pillar), and the likelihood of being caught as well as the level of punishment (regulative pillar) on the tax morale of business actors.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

One of the social obligations to the state is paying taxes. Business owners pay taxes to support the government and, at the same time, expect the benefits. Therefore, the government is expected to act reasonably and reliably in managing taxes (Frey & Torgler, 2007). According to Hug and Spörri (2011), positive government performance evaluation results will encourage business owners to be more cooperative with tax policies set by the government. When business owners believe that the government and tax authorities have worked well, a sense of trust will grow.

Furthermore, the slippery slope theory (Kirchler et al., 2008) states that high individual trust can foster the individual's compliance to pay taxes. However, if business owners perceive the government and tax authorities as untrustworthy and dishonest, this can undermine positive attitudes toward tax compliance (Murphy, 2004). Government authorities will be damaged when business owners feel that their contributions and benefits received from taxes need to be balanced (Alon & Hageman, 2013). In this situation, business actors will tend to migrate to the informal sector or commit tax evasion by not reporting their business activities.

The research of Mickiewicz et al. (2019) has found a significant positive relationship between trust in the government and tax morale. This study emphasizes the need to distinguish between trust in government and the specific impact of confidence in the tax system itself. This study

argues that trust in government and, more specifically, in those aspects of government that are most directly related to taxes, such as the tax office and the taxation system, will affect the tax morale of business owners. This opinion is in line with research conducted by Panjaitan (2019), Basri & Al Azhar (2017), Khaerunnisa & Wiratno (2014), and Lago-Peñas & Lago-Peñas (2010), which state that trust has a significant positive effect on tax morale. As such, the following hypothesis is formulated:

H1 : Business owners who express trust in the government have higher tax morale.

H2 : Business owners who trust tax administration have higher tax morale.

Individuals adopt a social identity that defines their role, limiting how they behave. Social identity theory (Tajfel, 1972) assumes that what an individual does is a manifestation of collective values usually preserved in a social group in which the individual is a part. Hogg et al. (1995) also stated that social identity implies that individuals see themselves as members of a social group and that individual behavior adopts the perspective of that group. Some forms of cooperative behavior become taken for granted and are no longer questioned at a deeper level of identification. On the other hand, loose identification leads to the possibility of non-compliance (Scott, 2014).

The sense of belonging and pride in being part of the Indonesian state shapes what should be done as an Indonesian citizen. Studies on tax morale have found that indicators of social identities, such as patriotism and nationalism, are positively related to tax morale (Heinemann, 2011). Research by Panjaitan (2019) and Torgler & Schneider (2005) concluded that the greater the pride of national identity, the higher the individual's intrinsic motivation to pay taxes. Khaerunnisa and Wiratno's (2014) research also mentions that a person's feelings of love for his country will foster a sense of pride, motivating a person to do good things for his country. Based on the results of the empirical research, the following hypothesis is formulated.

H3 : Business owners with tremendous pride in their country have higher tax morale.

Scott (2014) states that the regulatory process is formulating rules, monitoring, and sanctioning activities. The cause of a person being disobedient or choosing to evade taxes, according to Allingham and Sandmo (1972), is a trade-off between the profits obtained and the possibility of being investigated and fined. Rational choice theory (Becker, 1974) also assumes that individuals have preferences among several choices that allow the individual to state the desired option by considering available information, the possibility of events, and the potential costs and benefits of the available alternatives. This is reinforced by the research of Heinemann (2011), which argues that tax morale is influenced by an egocentric bias, which states that a person will adjust his behavior based on their interests. Furthermore, Blanthorne and Kaplan (2008) suggest that taxpayers have lower tax morale in a job with a more significant opportunity to avoid taxes.

In the slippery slope theory, prevention factors are also part of the authorities' authority, affecting individual compliance in paying taxes. Therefore, the prevention factor affects a person's tax morale. Sanctions are also considerations for someone to pay obediently or evade taxes. The research of Mickiewicz et al. (2019) concludes that someone who thinks the chance of being caught is greater when committing tax evasion and the severity of the punishment received has a significant positive effect on tax morale. Therefore, this study formulates the following hypothesis.

H4 : Business owners who perceive a greater likelihood of being caught in tax evasion tend to have higher tax morale.

H5 : Business owners who perceive tax evaders to be punished more severely when caught tend to have higher tax morale.

3. METHOD, DATA, AND ANALYSIS

This section describes methods of selecting and collecting data, measurement and operational definition of variables, and data analysis methods. Just like the previous section, the first paragraph at the beginning of the section or sub-section is not written indented.

3.1 Sample, Selection, and Data Sources

This study wanted to observe the effect of several factors based on Mickiewicz et al. (2019) research on the tax morale of micro, small, and medium enterprises in Java. MSME owners were chosen as the population because, according to Mickiewicz et al. (2019), small-scale companies tend to practice tax evasion by not reporting all their business activities compared to large companies that avoid taxes legally to minimize their tax obligations. According to data from the Ministry of Cooperatives and SMEs, MSMEs also significantly contribute to Indonesia's GDP, reaching 60.51% and absorbing 96.92% of the workforce in 2019. The composition of micro, small, and medium enterprises also makes up the majority of business units in Indonesia. There are 65.46 million units in Indonesia or the equivalent of 99%. MSMEs are one sector in which it is challenging to monitor fulfilling their tax obligations. This difficulty is because most MSMEs are still engaged in the informal sector (Ministry of Finance, 2020).

Several reasons are underlying the research locations throughout the province of Java. First, several island areas are met by people from various ethnic groups, customs, religions, and different backgrounds. In the first quarter of 2020, Indonesia's economic structure was partially dominated by groups of provinces on the island of Java, contributing 59.14% to Indonesia's GDP (Central Bureau of Statistics, 2020). Furthermore, based on the 2014 report on the competitiveness of MSMEs in Indonesia by Bappenas, it is explained that the productivity index is relatively high for each province in Java, including DKI Jakarta (100), West Java (27.09), Banten (24.56), East Java (14.71), Central Java (13.32), and DI Yogyakarta (12.12).

This research is quantitative research using primary data obtained through questionnaires. The sample selection technique uses a non-probability sampling approach, namely accidental sampling. Accidental sampling can be interpreted as a sampling technique based on coincidence. Anyone willing to fill out a research questionnaire suitable as a data source can be used as a sample (Sugiyono, 2018). A research sample is some MSME owners who are domiciled in Java and willing to complete a questionnaire via a Google form. The number of sample members is often expressed by the sample size and is determined by the Krejcie and Morgan formula in this study. According to this formula, for a population of more than 1 million, 384 samples are needed.

3.2 Variables

The variables used in this study adopted by Mickiewicz et al. (2019) research are as follows.

Table 1 Variable
Source: Adapted from Mickiewicz et al. (2019)

No.	Variable Name	Description
Dependent Variable:		
1	Tax morale	Is it justifiable to do tax fraud when the opportunity arises?
Independent Variable:		
1	Trust in Government	How much do you trust the government?
2	Trust in Tax Administration	1. Tax authorities are corrupt (reverse coded). 2. The tax authorities manage taxation fairly. 3. Tax authorities behave honestly.
3	Nationalism	Being an Indonesian citizen is important to me
4	Likelihood of being caught	1. What are the chances of someone being caught for underreporting operating income? 2. What is the probability that someone is caught for underreporting the number of employees? 3. What are the chances of someone being caught for underreporting an employee's salary?
5	Severity of punishment	What is the impact on companies that receive penalties for reporting less income than they should?
Control Variable:		
1.	Female, Education	
2.	Age	
3.	Employee	
4.	Sector	
5.	Performance	

3.3 **Data Analysis**

The research method used is a quantitative method with the following basic equations.

$Tax\ morale_{i,t}$ $= \alpha + \beta_1 Trust\ in\ government_{i,t} + \beta_2 Trust\ in\ tax\ administration_{i,t} + \beta_3 Nationalism_{i,t} + \beta_4 Likelihood\ of\ being\ caught_{i,t} + \beta_5 Severity\ of\ punishment_{i,t} + Female + Education + Age + Employees + Sector + Performance + \varepsilon$ (1)

Hypothesis testing in this study uses Ordinary Least Squares (OLS), which begins with testing the research instrument and must meet Gaus Markov's assumptions. The research instrument testing conducted on the data from the questionnaire included validity and reliability tests. Research data must also be BLUE (Best Linear Unbiased Estimator). Furthermore, hypothesis testing uses the coefficient of determination test, simultaneous test (f-test), and partial test (t-test).

4. **RESULTS AND DISCUSSIONS**

Research data has been collected through the distribution of questionnaires with as many as 395 respondents' answers. The questionnaire collection results showed the respondents' profile consisting of gender, age, education, business sector, and business domicile. Respondents of the female sex dominated as many as 246 respondents and male respondents as many as 149 respondents.

Based on age, respondents were grouped into three categories. In the first category, with an age range of 18 – 31 years, there are 170 respondents. In the age range of 32-44 years, there are 115 respondents. Respondents over 45 years of age are in the minority, with 110 respondents.

Based on education level, research data is dominated by respondents with the latest education S1/Diploma IV with 180 respondents. Furthermore, the education level is Masters with 64 respondents (16.2%), Diploma with 59 respondents (14.9%), SMP/Equivalent with five respondents (1.3%), and SD/Equivalent with one respondent or 0.3 % of the total respondents.

Based on the business sector, respondents were dominated by other sectors, with 194 respondents or 49.1%. The second-largest business sector is retail trade, with 122 respondents or 30.9%. Respondents with the service business sector are 51 (12.9%), wholesale trade is 22 (5.6%), and manufacturing is 6 or 1.5% of the total respondents.

Based on the business domicile, most respondents were domiciled in the DKI Jakarta area, namely 213 or 53.9%. Furthermore, the area with the second-largest respondent is West Java, with 43 respondents or 15.7%. The distribution of data for other regions in Central Java with 43 respondents (10.9%), East Java with 32 respondents (8.1%), Banten with 27 respondents (6.8%), and DI Yogyakarta with the least respondents with 18 respondents or 4.6% of the total respondents.

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Table 2 Regression
Source: Processed from SPSS 25

Variabel	Unstandardized Coef.		T	Sig.
	B	Std. Error		*One-tailed*
(Constant)	1.853	0.953	1.945	0.026
Trust in government	0.524	0.162	3.242	0.000
Trust in tax administration	0.504	0.149	3.380	0.000
Nationalism	0.256	0.143	1.794	0.037
Likelihood of being caught	0.351	0.154	2.272	0.012
Severity of punishment	0.373	0.137	2.728	0.003
Adj r^2	0.155			
F (sig)	.000^b			

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4.2 Regression Analyisis

Based on Table 2, the coefficient of determination (R2) value is 0.155. This coefficient means that the independent variables and control variables in this research model can explain the variation of the dependent variable by 15.5%. The significance value (F sig) is 0.000 < 0.05, so H0 is rejected, and H1 is accepted so that it can be concluded that the independent variables have a simultaneous effect on tax morale. Based on the results of the t-test in Table 2, the significance value is less than alpha 0.05, so H0 is rejected, and H1 is accepted. Therefore, all research hypotheses were accepted.

4.3 Discussion
4.3.1 The Effect of Trust in Government on Tax Morale

Business owners pay taxes as a form of obligation to the government so that later, they can reap the benefits of their contributions. This study found that a business owner who believed in the government tended to have higher tax morale. The results of this study are supported by the slippery slope theory (Kirchler et al., 2008), which assumes that trust in the government will make business owners obey existing regulations, including compliance with tax obligations, because they believe that the provisions made by the government will have a good impact. The research of Mickiewicz et al. (2019) states that tax morale can be improved by having confidence in how the tax is collected and spent as government expenditure has gone well and correctly.

A positive assessment of the evaluation of the implementation of taxes makes business owner cooperative with government policies (Marien & Hooghe, 2011). Based on the questionnaire data, it is known that 49.4% of business owners expressed confidence, and 7.1% of business owners expressed greater confidence in the government's performance. Business owners who carry out tax obligations because they believe in the

government indicate the emergence of social legitimacy. Social legitimacy is seen as quite important. Mickiewicz et al. (2019) add that the lack of social legitimacy will cause business owners to choose to refrain from paying taxes or evading their taxes by not reporting all of their business activities.

Khaerunnisa and Wiratno's (2014) research finds that when the level of trust in the government is highest, citizens will be motivated to carry out their tax obligations. This is due to their confidence in the government that the income from this tax will help in development. Other studies, Basri & Al Azhar (2017), Hug & Spörri (2011), and Lago-Peñas & Lago-Peñas (2010), have similar results, trust in the government has a positive influence, which means the more significant the trust, the tax morale will increase.

4.3.2 The Effect of Trust in Tax Administration on Tax Morale

When a business owner states that he believes the tax administration has been running fairly, he tends to have higher tax morale. The conclusions resulting from this study are in line with Mickiewicz et al. (2019), who concluded that trust in tax administration positively affects tax morale. As has been explained in the previous hypothesis regarding the trust in the government variable, the results of the evaluation of the implementation of tax administration also affect the behavior of business owners. According to Murphy (2004), a person's tendency to choose to cooperate and comply with predetermined behavior is influenced by a sense of obligation. This feeling can increase or decrease depending on the evaluation of the relevant institution. According to Mickiewicz et al. (2019), perceptions of justice are essential and can be achieved without arbitrariness and favoritism in tax services.

Poor administrative practices can lead to corruption and favoritism. Suppose business owners think that the tax authorities are dishonest, corrupt, and do not believe the rules used in collecting tax revenue and spending it are fair. In that case, it can weaken the positive attitude of paying taxes and justify tax evasion. This is

confirmed by the findings of Torgler et al. (2008), who found empirical evidence regarding the assessment of the tax collection process that is honest, not corrupt, and fair, associated with high tax morale. Mickiewicz et al. (2019) also state that if business owners think that the benefits they receive are not balanced with their contribution, it will encourage business owners to migrate to the informal sector.

Based on the questionnaire data, it can be concluded that most respondents think that the implementation of tax administration in Indonesia has been running honestly and fairly. This aligns with the slippery slope theory, which argues that the emergence of trust will encourage business owners to obey the rules. Therefore, the tax authority should improve its image by providing information regarding how the tax is collected and spent effectively and efficiently.

4.3.3 The Effect of Nationalism on Tax Morale

When a business owner expresses intense pride in his country, he tends to have higher tax morale. Social identity theory (Tajfel, 1972) assumes that what an individual does is a manifestation of collective values usually preserved in a social group in which the individual is a part. This theory is supported by Hogg et al. (1995), which states that social identity implies that individuals see themselves as members of a social group and that individual behavior adopts the perspective of that group. Nationalism is seen as the self-perception of individuals who feel they belong to a particular group of countries and believe they must contribute to that group. Mickiewicz et al. (2019) also state that external cultural systems shape individuals' interpretations of their environment and guide how they should act.

A sense of pride in being a citizen increases the motivation of business owners to contribute to the country by being obedient in paying taxes. This conclusion is supported by research by Khaerunnisa and Wiratno (2014), which states that one's love for Indonesia will create a feeling of pride in being a citizen so that this factor can

motivate a person to do good things for his country to ensure that his country can run well.

Based on the questionnaire data, it is known that most of the respondents stated that being an Indonesian citizen is essential for them. The results of the descriptive analysis also explain that the respondents have relatively high nationalism. It implies that the people are proud to be Indonesian citizens. Feelings of pride make people behave cooperatively consciously without any doubt and further increase the intrinsic motivation to pay taxes, as research has been done by Torgler and Schneider (2005) in Austria.

4.3.4 The Effect of Likelihood of Being Caught on Tax Morale

When business owners state that tax evaders' opportunity to be caught is more significant, they have higher tax morale. The study results align with the conclusions of Mickiewicz et al. (2019), which state that the likelihood of being caught has a positive effect on tax morale. According to Scott (2014), the third pillar of the institution is regulation, relating to the activities of setting rules, monitoring, and imposing sanctions. Rules are set to provide limits for community behavior, and monitoring is carried out to evaluate whether the rules have been adhered to properly. Scott (2014) adds that individuals comply with laws and regulations because they seek the accompanying rewards or avoid existing sanctions. Rational choice theory (Becker, 1974) also assumes that individuals have preferences among several choices that allow the individual to state the desired choice by considering available information, the possibility of events, and the potential costs and benefits of the available choices, and acting consistently in choosing the best course of action.

Concerning tax morals, according to Allingham and Sandmo (1972), the cause of individuals to disobey or choose to evade taxes by not reporting or reporting income but less than it should be is a trade-off between the profits earned and the probability of detection and fines (penalties). In other words, if the possibility of someone being caught through a rigorous inspection mechanism due to tax evasion is

greater, the business owner will prefer to comply with his tax obligations. This is because business owners assume that the costs to be incurred will be greater than the profits obtained. This statement is also reinforced by research by Heinemann (2011), which argues that tax morale is influenced by an egocentric bias, which states that someone will adjust their behavior based on their interests.

Based on the slippery slope theory, one of the reasons people comply with tax obligations is the authority of the authorities. The authority of the authority relates to the ability of the tax authority to detect and punish tax violators. The results of the questionnaire data show that the perception of the opportunity for business owners to be caught for committing tax violations only ranges from 25-50%. The Directorate General of Taxes' performance report also explained that the audit coverage ratio in 2019 only reached 1.58%, lower than the IMF benchmark, which was 2%. It can illustrate the ability of the DGT to detect tax violations. Therefore, the implementation of the results of this research needs to be carried out by the DGT by increasing the scope and quality of tax audits so that the possibility of tax evasion being detected will be even more significant and will increase the tax morale of business owners.

4.3.5 The Effect of Severity of Punishment on Tax Morale

According to Scott (2014), one of the pillars of regulation is the provision of sanctions. Giving sanctions/punishments is a deterrence variable according to the slippery slope theory. The analysis of the benefits and costs of this deterrence variable can affect tax morale because individuals will usually adjust their norms or attitudes according to their interests (Mickiewicz et al., 2019). Rational choice theory (Becker, 1974) states that individuals have preferences among several choices by considering the potential costs and benefits of the available options. Based on this theory, the business owner's decision to comply with paying taxes or embezzling taxes considers the benefits derived from reduced taxes paid and the number of sanctions received later if caught violating tax rules.

The imposition of sanctions is a stimulus in growing tax morale for business owners. It is also in line with the research results of Mickiewicz et al. (2019), which conclude that the level of punishment received by perpetrators of tax evasion has a significant positive effect on tax morale. Most respondents in this study argue that the sentence received by the perpetrators of violations, namely the business owner, will bear a fine. With sanctions, business owners will be motivated to pay taxes according to applicable regulations because they find it difficult to pay tax penalties.

The authorities in the slippery slope theory include monitoring activities and providing sanctions. Based on the regression results from the research model, it is known that the severity of punishment has less significance than the likelihood of being caught and has a more significant coefficient. The severity of punishment can be concluded to have a more substantial influence on tax morale than the likelihood of being caught. Therefore, the imposition of sanctions/penalties should be adjusted to the applicable rules and regulations. The size of the sanction/punishment is also adapted to the level of the violation committed. It is done so that the tax authorities still guarantee the creation of justice.

5. CONCLUSION

This study aims to find the relationship between trust in government, trust in tax administration, nationalism, the likelihood of being caught, the severity of punishment and tax morale. From the result of data processing, conclusions can be drawn as well as answering the formulation of the problem in this study that trust in government, trust in tax administration, nationalism, the likelihood of being caught, and severity of punishment have a positive and significant effect on the tax morale of MSME in Java.

6. IMPLICATIONS AND LIMITATIONS

This study has limitations that can affect the final result of the research. These limitations and constraints include: first, the research object is only limited to the owners of MSMEs domiciled in Java. Second, the research time is short, so the authors use non-probability sampling techniques. Third, the dissemination of questionnaires through Google form media so that respondents fill in without the assistance of the author results in differences in respondents' understanding of the contents of the questionnaire.

Further researchers can complete this research by expanding the research object, using other sampling methods, multiplying sources and literature relevant to the study, and using other variables not used in this study.

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