

# Tax knowledge, Tax Morale, and Tax Compliance : Taxpayers' View

**Kustiawan, Memen; Prawira, Ida Farida Adi\*); Zulhaimi, Hanifa; Solikin, Ikin**

*\*Departemen of Accounting, Faculty of Economic and Business Education,  
Indonesia Education University  
229th Dr. Setiabudhi Street, Bandung, West Java, Indonesia 40154*

**Abstract:** The purpose of this study is to measure the tax knowledge and tax morale of government treasurers in colleges in complying with the taxation provisions. The study was conducted at four government colleges in West Java using a descriptive analytic method with a qualitative approach. The results show that treasurers have tax knowledge and tax morals that are good in complying with tax regulations so there are not many obstacles in fulfilling their tax obligations. The limitations of this research are that the research is still not wide enough so that there is still very limited data obtained.

**Keyword:** tax knowledge, tax morale, tax compliance, government treasurers

## I. Introduction

Tax compliance seems to depend upon numerous factors beyond the standard economic ones of deterrence, and, given the level fines and audit rates in most countries (in combination with available estimates of risk aversion), deterrence models predict far too much compliance and far too little tax evasion (Alm, McClelland, and Schulze, 1992; Frey and Feld, 2002). Elffers (2000) points out that "...the gloomy picture of massive tax evasion is a phantom". Long and Swingen (1991) argue that some taxpayers are "...simply predisposed NOT to evade". and thus do not even search for ways to cheat at taxes (Frey and Foppa, 1986). Pyle (1991, 173) criticises the assumption that individuals are amoral utility maximisers: "Casual observation suggests that not all individuals think quite like that. Indeed, it seems that whilst the odds are heavily in favour of evaders getting away with it, the vast majority of taxpayers behave honestly". In the face of these difficulties, many researchers have suggested that the intrinsic motivation for individuals to pay taxes - what is sometimes termed their "tax morale" - differs across countries; that is, if taxpayer values are influenced by cultural norms, with different societal institutions acting as constraints and varying between different countries, then tax morale may be an important determinant of taxpayer compliance and other forms of behavior. However, isolating the reasons for these differences in tax morale is notoriously difficult.

In a common approach, studies sometimes referred to as "cultural studies" have often relied upon controlled laboratory experiments conducted in different countries because such experiments can be set up with identical experimental protocols to allow cultural effects to be isolated. For example, Alm, Sanchez, and De Juan (1995) compared identical tax compliance experiments conducted in Spain and the United States, two countries with very different cultures and histories of compliance. They found that subjects in the United States consistently exhibited higher compliance than subjects in identical experiments in Spain, and attributed these differences to a higher "social norm" of compliance in the United States.

Kirchler et al. (2008) claim that trust in authorities is a substantial determinant of tax compliance which can only be enforced partly by the legitimate power of tax authorities to audit tax files, impose and prosecute penalties on tax evaders. Empirical evidence suggests that educating tax payers about the tax system (Vogel 1974, Song and Yarbrough 1978, Wartick 1994), tax laws (Eriksen and Fallan 1996, Palil and Mustapha 2011) and informing them about negative effects of tax evasion (Holler et al. 2008), sanctions and fines (Schwartz and Orleans 1967, Park and Hyun 2003) is a

useful policy in order to increase trust in authorities, conveying to significantly more tax compliance. The present study contributes to this literature by investigating how firstly tax knowledge about public expenditures and secondly tax payers' influence on budget spending affects tax compliance. Local governments seem to be well aware of the importance of tax knowledge about public expenditures to increase trust in authorities.

Field studies in Switzerland report higher tax compliance and tax morale in regions where citizens can actively vote for budget spending (Pommerehne and Weck-Hannemann 1996, Feld and Frey 2002, Torgler 2005). Experimental literature on the concept of voice pioneered by Alm et al. (1993) support the findings of the field studies. The authors conduct a public good experiment with groups of 5 where each subject individually receives income and then decides how much to provide for the underlying public good. Contributions are much higher if subjects are able to vote for the public good that is funded by their taxes. Wahl et al. (2010) also argue that high contribution results when the public good, for which citizens vote, is congruent with their own preferences.

In this paper we further investigate whether tax knowledge and tax morale in four colleges in West Java, Indonesia. In the next section we briefly discuss previous cross - college findings, and introduce the concept of tax knowledge and tax morale. In section III we present our empirical results, in section IV we finish with some concluding remarks.

## II. Literature Review

### Tax Knowledge

Tax knowledge is the level of awareness or sensitivity of the taxpayers to tax legislation. Tax knowledge refers to the processes, by which taxpayers become aware of tax legislation and other tax-related information (Hasseldine et al., 2009). The level of formal general education received by taxpayers is an important factor that contributes to the understanding of tax requirements, especially regarding registration and filling requirements. Generally, citizens have very limited knowledge on government true expenditures and the cost of public services provided by the government (Csontos et al., 1998). Hence, those taxpayers without tax knowledge are compelled to solicit the service of tax professionals (Chattopadhyay and Das-Gupta, 2002 ; Loo and Ho, 2005). One of the fundamental ways to increase public awareness is for taxpayers to have knowledge about taxation (Mohani, 2001; Saira et al., 2010). Reference (Richardson, 2006) observes that general education level is significantly related to tax evasion. High awareness by the society would encourage people to fulfill their obligations to register as taxpayer reporting and paying taxes properly are forms of national and civic responsibility. Most citizens do not have much understanding of what tax laws mean and why the tax system is structured and administered as it is ( Braithwaite, 2007). Reference (Palil, 2010) states that tax knowledge reveal that there is a relationship with taxpayers' ability to understand the laws and regulation of taxation and their ability to comply. In this study, SMEs did not consider local authority levies to be different from government taxes because they lacked tax knowledge. This misconception has an impact on their compliance decision because when they pay council levies they might consider that they have to understand tax law requirements. Increase awareness and knowledge of a tax initiative is essential to gain public acceptance and confidence (Saira et al., 2010). Awareness has to be spread in order to inform all consumers about the direction and objectives the authorities wish to achieve by administering taxation policy (Yan et al., 2010). References (Palil and Mustapha, 2011; Saad, 2012) conclude that tax knowledge has a significant impact on tax compliance in meeting their tax obligations. Similarly, Reference (Mukasa, 2011) also opines that knowledge of taxation can affect the perceived fairness of tax by the taxpayers. For taxpayers to accurately compute his tax liability reasonable tax knowledge is required (Lai et al., 2013). From the foregoing, it is observed that previous studies have evidenced that tax knowledge play an important role in increasing tax compliance. Tax knowledge could potentially encourage taxpayers to be more prudent in completing their tax returns. Hence, we hypothesized that there is a significant relationship between tax knowledge and tax compliance.

### Tax Morale

Studies related to tax morale were not receiving a lot of attention from scholars until the beginning of 70s. However since that time issues related to tax morale are becoming more important. The pioneering researches in the field of tax morale were done by German scientists well known as a "Cologne school of tax psychology". The first studies related to tax morale were analyzing its relationship with tax compliance, shadow economy and employment type. This section will provide the fundamental theoretical aspects related to tax morale. One of the first studies in the literature of tax morale was done by G. Schmolders (1960). He explained tax morale *as the attitude of a group or the whole population of taxpayers regarding the question of accomplishment or neglect of their tax duties; it is anchored in citizens' tax mentality and in their consciousness to be citizens, which is the base of their inner acceptance of tax duties and acknowledgment of the sovereignty of the state* (G.Schmolders, 1960, pp. 97-98). According to the author tax morale is closely related towards the attitude of individual. It is worth to highlight that significant difference between the attitude and behavior exists in terms of

taxation this issue refers to the difference between tax morale and tax evasion. In other words tax morale is the perception of taxpayers towards tax evasion. G. Schmolders (1960) as a proxy in order to evaluate the level of tax morale used tax evasion. Another important aspect is that tax mentality and individual's consciousness are mostly affected by taxpayers' intrinsic values. However this perception on tax morale was a subject to changes and different interpretations.

Other valuable contributions in terms of theoretical background for tax morale were by B.S. Frey (1997) defines tax morale as an intrinsic motivation to pay taxes. This concept was widely accepted by the majority of scholars analyzing issues of tax morale (Torgler & Schneider 2009; Radlane, 2012; Pope & Mohdali, 2010). B.S. Frey (1997) highlights that the biggest part of economic models related to human behavior are based on extrinsic motivation. It means that decisions taken by individuals are mostly caused by external determinants. On the other hand he argues that intrinsic determinants are very important and relevant as well, especially in terms of tax morale. According to the author people are making decisions based on both extrinsic and intrinsic motivation. It is not just extrinsic determinants such as recognition or material gain important but also intrinsic determinants such as satisfaction. Author also suggests one more important determinant which must be taken into consideration when analyzing tax morale – spillover effect. If policy makers decide to increase taxes this effect becomes very important because it can cause reduction of tax morale. Usually taxpayers will support initiatives to decrease tax burden in this case trust in government will decrease as well and the risk for tax morale will increase.

J.G. Cullis and A. Lewis (1997) agreed with the proposition that taxpayers' behavior is determined not only by utility maximization. According to them it is caused by intrinsic motivation and understanding of a civic duty. Authors highlight that standard economic approach is not appropriate in order to evaluate taxpayers' behavior. Authors proposed to evaluate following individual determinants:

1. values and norms;
2. attitudes;
3. fiscal consciousness;
4. compliance.

J.G. Cullis and A. Lewis (1997) explanation stays in line with understanding that tax morale can be denoted as intrinsic motivation to pay taxes caused not only by rational, utility maximizing behaviour. G. Schmolders (2006) emphasises the importance of difference between morale and tax morale. According to him the general level of morale is higher than of tax morale. The main reason is that taxation rules are not as obligatory as others in the taxpayers' mind. People still believe that breaking taxation rules will not affect anybody else. General understanding about the importance of taxes and their redistribution function is quite poor. Also in some cases psychological reasons can influence decision whether to pay taxes or not. There is no link between paying taxes and social prestige. On the other hand M. Sandmo and M.G. Allingham (1972) argue that person who is avoiding taxes faces reputational risk. G. Schmolders (2006) also draws a link between tax mentality and tax morale because it can differ among countries, regions and individuals. B. Torgler (2003) was pioneering scholar in analysing tax morale as dependent variable. In the previous researches tax morale usually were analysed as a residual explanation. In order to answer the question why people pay taxes instead of avoiding them B. Torgler (2003) proposed the typology of taxpayers. Author classified four different types of taxpayers:

1. social taxpayer;
2. intrinsic taxpayer;
3. honest taxpayer;
4. tax evader.

This typology is a very important finding in the further analysis of tax morale. Social taxpayers tend to pay taxes because it is a social norm. This group of individuals is dependent on other people opinion. Motivation to pay taxes is rather extrinsic – coming from external determinants such as friends influence. On the other hand social taxpayers are scared of being penalized in this case they would feel ashamed. Another group of taxpayers is called intrinsic taxpayers. According to B. Torgler (2003) this group of individuals are influenced by their intrinsic values and norms. Public pressure is not very important for them. Intrinsic motivation to pay taxes increases when they are satisfied with government and tax administrators. Honest taxpayers are the most tax moral group in this typology. This group of individuals tend to pay taxes in every situation. They are not trying to search possibilities how to evade taxes or how not to comply with the law. Also policy makers' decision to increase tax rates does not influence their decision to pay all taxes. Tax payers of this group have the highest level of tax morale. The last group of tax payers is classified as tax avoiders. This group of individuals tends to maximize their utility function. It means that they are taking into

consideration all changes in the tax law, audit probability and amount possible penalty. Tax morale for this category is the lowest.

J. Alm and B. Torgler (2006) argued that tax morale as an intrinsic motivation to pay taxes are determined by social norms, attitudes, values and significantly differs among individuals and countries. Also they proposed that tax morale is strongly negatively correlated with tax evasion. The size of shadow economy is represented as a percentage of GDP. Shadow economy is captured using DYMIMIC approach which takes into account variables such as tax burden, tax morality, labour and production market factors as well as various monetary indicators. Tax morale is captured from the World Values Survey question "Do you justify cheating on tax if you have a chance". Possible answers are in the range from 1 (never justify) to 10 (always justify).

### **III. Methodology**

This research uses descriptive analytic method with qualitative approach. The use of this qualitative approach is based on the concept of natural setting, grounded theory, and is descriptive, prioritizes the process rather than results, the design is temporary, and the research results are negotiated and mutually agreed upon. The research was conducted on the Treasurer at four colleges, namely Universitas Pendidikan Indonesia, Universitas Padjadjaran, Politeknik Bandung, and Poltekes Tasikmalaya. With the aim of being able to dig up information related to what had been done by the Treasurer as a harvester of ASN income tax in the university environment, then what was the obstacle in fulfilling it. So that by extracting information in this study, we can formulate any strategies that should be implemented to improve ASN taxpayer compliance.

Tax knowledge is measured by several questions, including :

1. "How do you answer taxpayers' questions in your work environment when they complain?"
2. "What problems do you face in the process of deducting taxpayers' income tax?"
3. "Are you deducting your income tax proof and distributing it to taxpayers?"

Then, tax morale is measured by several questions, including:

1. "how important is the taxpayer fulfilling his tax obligations?"
2. "What do you do with income tax that has been deducted from the taxpayer? Do you make deposits to the state treasury directly or do you settle the income tax at the bank?"

### **IV. Results**

From the results of interviews and observations in the field, we get the following data:

#### **Tax Knowledge:**

1. "How do you answer taxpayers' questions in your work environment when they complain?"

The four respondents giving similar responses, namely questions or complaints coming from taxpayers in the college environment they are responsible for what they understand and refer to the applicable tax laws. As for the details or technical fulfillment of tax obligations, the treasurer does not know many things, only matters relating to his duties and functions as treasurer in the college. This can be said to be reasonable, and the treasurer is considered to have had an adequate level of knowledge about the business processes in the place of work and know enough details about all matters relating to tax obligations.

2. "What problems do you face in the process of deducting taxpayers' income tax?"

In terms of the constraints faced by respondents in carrying out their duties, several answers include:

1. not yet understand how to implement progressive tax rates
2. delays in data from work units for tax calculation basis
3. taxpayers receive additional income that is different, thus making the treasurer troubles in cutting income tax

### 3. "Are you deducting your income tax proof and distributing it to taxpayers?"

Proof of income tax deduction is automatically made by the treasurer, but in the distribution there are several respondents who answer that the piece of evidence is not distributed automatically but if the taxpayer asks them only. It shows us that not all taxpayers have a concern in fulfilling their tax obligations, especially in reporting tax returns. Because the proof of income tax deduction is required by the taxpayer in making his income tax report in tax return.

#### Tax Morale

##### 1. "how important is the taxpayer fulfilling his tax obligations?"

All respondents answered that it was very important for them to fulfill their tax obligations, as a sense of responsibility as tax-compliant citizens. Besides that, the role of treasurer in the college in implementing tax regulations is very strategic in encouraging taxpayer compliance in fulfilling the income tax obligations owed to them. In addition, there are respondents who think that taxation regulations in Indonesia that often occur change make it difficult to implement difficulties. Not yet finished learning the rules, now there are new rules. Sometimes the treasurer feels tired of dealing with it so that he chooses to do his job just so, not wanting to bother with the new rules.

##### 2. "What do you do with income tax that has been deducted from the taxpayer? Do you make deposits to the state treasury directly or do you settle the income tax at the bank?"

Income tax that has been deducted from the taxpayer is immediately deposited in the state treasury at the beginning of the following month, so that the money that has been entered does not occur in the college account. This is done in addition to fulfilling tax obligations as treasurer in fulfilling tax regulations, as well as treasurer in complying with the management of funds originating from the state. So for this reason all respondents were uniform in answering that there were no funds deposited in the college account.

## V. Conclusion

This study aims to determine the extent to which tax knowledge and tax morale of college treasurers fulfill their tax obligations, by conducting face-to-face interviews and field observations. The results of this study indicate that treasurers have sufficient knowledge and have good morals in carrying out their tax obligations. They do not do things that violate the provisions of the taxation and the management provisions of the country. It's just that there are several obstacles they face in fulfilling their obligations. These obstacles can be corrected by various businesses, including universities must be more responsive in the face of changes in tax regulations that occur by communicating intensively with tax officials and asking tax officers to provide information to the treasurer as often as possible. Besides that, the taxation system in universities must be well-made. No longer manual taxpayer data entry, so the system has automatically calculated the value of tax payable income on income received by the taxpayer. The treasurer will no longer have to wait for manual data inputted by other units, the treasurer will not bother to calculate the manual how much income tax is payable on the income received by the taxpayer. For the next research, it is recommended to do a broader research and use better research methods, so that it will produce better data in increasing the wealth of knowledge.

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