

TAX COMPLIANCE IN INDONESIA: A LEGITIMACY PERSPECTIVE

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Abstract

The hard efforts of the tax authorities in Indonesia to improve their regulations in order to increase taxpayer compliance have not been satisfactory, considering that the level of taxpayer compliance in reporting the Annual Tax Return (SPT) in 2017-2021 is still the highest at 84.07%. Based on the background, analysis and discussion, it is concluded that the occurrence of tax avoidance and tax evasion, which causes a decrease in the level of compliance and not maximizing tax revenue, must be handled by strengthening tax legitimacy (law) in Indonesia. Strengthening tax legitimacy in Indonesia must be based on the elements of legitimacy in the form of cognitive legitimacy, moral legitimacy, and pragmatic legitimacy.

keywords: *tax compliance, legitimacy theory, tax rights and obligations*

A. Introduction

Since Indonesia implemented several tax laws in 1983, such as Law No. 6 of 1983 on General Provisions and Procedures of Taxation, Law No. 7 of 1983 on Income Tax, and Law No. 8 of 1983 on Value Added Tax, the country expects a significant increase in taxpayer compliance. One of the significant changes that will also be a big challenge for the tax authority, namely the Directorate General of Taxes (DGT), is the change in tax collection from the official system to the self-assessment system (SAS), as stipulated in Law Number 6 of 2023 concerning the Stipulation of Government Regulation in place of Law Number 2 of 2022 concerning Job Creation into Law (KUP Law) which states that every taxpayer is obliged to fill out a Tax Return correctly, completely, and clearly to the Directorate General of Taxes (DGT) office.

Forty years since the enactment of the KUP Law in 1983, tax authorities in Indonesia still face challenges related to SAS, one of which is compliance with the reporting of tax returns that must be filled in and reported by taxpayers themselves. Some empirical evidence shows that tax compliance still needs improvement despite regulatory improvements. First, although taxpayer compliance in reporting annual tax returns and paying taxes has tended to increase in the last five years, the compliance ratio for tax return reporting in 2017-2021 is still the highest at 84.07%. DGT noted that the compliance ratio of tax return reporting by taxpayers reached 84.07% in 2021 (with 15.9 million tax returns reported from 19 million taxpayers), the tax compliance ratio in 2020 was 78%, the tax compliance ratio in 2019 was 73.06%, the tax

compliance ratio in 2018 was 71.1%, and the tax compliance ratio in 2017 was 72.58%.¹ Second, tax evasion is still rampant on a global and national scale. The global scale can be seen from the Panama Papers case that revealed 11.5 million leaked documents from more than 214,488 offshore entities since the 1970s. In addition, the Nasser investigation estimates that around USD200 billion of Indonesia's wealth is parked abroad, and around USD100 billion is in the country. Third, in Indonesian tax courts, several taxpayers have been found guilty of tax evasion, such as in the case of LKF as a director who was sentenced to imprisonment and a fine.²

DGT has worked hard to improve its regulations to increase taxpayer compliance. DGT has implemented tax amnesty or its equivalent several times from 1964 until 2022, including tax amnesty in 1964 and 1984, Sunset Policy in 2008, reinventing policy in 2015, and tax amnesty from July 2016 to March 2017. Some literature suggests that tax amnesty initiated by a country has two important objectives: increasing revenue and reducing taxpayer non-compliance.³ With regulations governing tax rights and obligations in Indonesia and the many efforts that the DGT has made to improve tax compliance in Indonesia, this study needs to answer problems related to how ideally tax compliance arrangements in Indonesia should be based on legitimacy theory.

B. Analysis and Discussion

1. Literature Review on Tax Compliance

The problem of tax compliance has arisen since tax collection was introduced. Research on tax compliance has become a very popular academic topic, as all modern societies face the challenge of addressing tax evasion and the harm this phenomenon causes to government revenues.⁴

Tax compliance has been studied from many perspectives, including public finance, law enforcement, organizational design, ethics, and several perspectives.⁵ Nuraprianti *et al.*⁶ and Alm⁷ emphasized that tax payment is part of taxpayers' compliance with the state. However, such compliance can be thwarted by tax evasion as individuals and companies do not pay their tax obligations promptly. Palil and Mustapha argued that the main tax administration approach used in determining tax compliance is SAS, as the supporting factors are, among others, the development of the level of tax knowledge among taxpayers; its application usually results in increased efficiency (such as reduction in the requirement to provide supporting documents and

¹ Vika Azkiya Dihni, (04/08/2022), "Rasio Kepatuhan Pelaporan SPT Pajak Tercapai 84% pada 2021", available at <https://databoks.katadata.co.id/datapublish/2022/08/04/rasio-kepatuhan-pelaporan-spt-pajak-tercapai-84-pada-2021> (accessed 25 September 2023).

² Verdict of the South Jakarta District Court number 1196/Pid.B/2009/PN Jkt.Sel, dated October 5, 2009.

³ Jeffrey A. Dubin, Michael J. Graetz, and Louis L. Wilde, "State Income Tax Amnesties: Causes," *The Quarterly Journal of Economics* 107, no. 3 (1992): 1061.

⁴ Paleka, Hana, and Vitezić, Vanja, (2023), "Tax Compliance Challenge through Taxpayers' Typology" *Economies* 11, no. 9: 219, <https://doi.org/10.3390/economies11090219>.

⁵ James Andreoni, Brian Erard, and Jonathan Feinstein. "Tax compliance." *Journal of Economic Literature* XXXVI (June 1998): 818.

⁶ Nuraprianti, D., Kurniawan, A., & Umiyati, I. (2019). Pengaruh Etika Uang (Money Ethics) terhadap Kecurangan Pajak (Tax Evasion) dengan Religiusitas Intrinsik dan Materialisme sebagai Variabel Pemoderasi. *Fair Value: Jurnal Ilmiah Akuntansi dan Keuangan*, 1(2), 199-217.

⁷ Alm, J. (2021). Tax evasion, technology, and inequality. *Economics of Governance*, 22(4), 321-343.

proof of income and costs to the tax authorities when submitting tax returns).⁸ Braithwaite argues that tax compliance can be improved by persuading and encouraging taxpayers to cooperate. Given that such strategies do not necessarily lead to high costs in the tax system, it is time for policymakers to implement such strategies and stimulate voluntary tax compliance.⁹ Then, Pertiwi et al. explained that, in turn, the perception of tax justice would encourage taxpayer compliance, considering that the theory of justice is built on a person's belief in the sense of fairness and feelings of unfairness, which will impact compliant and non-compliant behaviour.¹⁰ Furthermore, Doran and Das-Gupta et al. studied the factors that affect tax compliance. Doran concluded that tax sanctions determine the standard of behaviour that fulfils taxpayers' obligations to the government by distinguishing compliant taxpayers from non-compliant taxpayers. The findings indicate that tax compliance in the self-assessment system requires taxpayers to report their tax obligations only based on legal positions that they believe are reasonably correct and in good faith.¹¹ Das-Gupta et al. evaluated the impact of reforms in income tax administration policy on tax compliance in India. Taxpayers who voluntarily disclose higher income are thus placed in special assessment units. To avoid this, high-income taxpayers feel they have an additional incentive to understate their income.¹²

A more thorough study on the importance of tax compliance by wealthy taxpayers for public efficiency was conducted by Gangl and Torgler (2020). The study shows the need for a statistical clustering procedure by differentiating groups based on their monthly income. This would highlight a better understanding of the determinants of tax compliance of the rich and imply the need for practical solutions that would lead to an optimal and fair tax system for the middle, lower and upper classes. The results also show that while it is important to rely on economic frameworks, strong evidence suggests that taxpayers are motivated by factors other than purely financial ones. By understanding and improving tax morale and system fairness and analyzing norms, there is potential to increase revenue with minimal enforcement mechanisms.¹³

The various studies related to tax compliance show that tax compliance is built on a legal framework that is fair, certain, and beneficial. The legal framework must be legitimate for the people to implement it based on high voluntary compliance.

2. Legitimacy Theory and Its Importance in Improving Voluntary Compliance

⁸ Mohd Rizal Palil and Ahmad Fariq Mustapha, Factors affecting tax compliance behaviour in self assessment system, *African Journal of Business Management*, Vol. 5, No. 33, pp. 12864-12872, 2011, p. 12864.

⁹ Valerie Braithwaite (ed), 2003, *Dancing with tax authorities: Motivational postures and non-compliant actions*. In *Taxing Democracy Tax Avoidance and Tax Evasion*. Ashgate: Aldershot, pp. 93–108.

¹⁰ Pertiwi, A. R., Iqbal, S., & Baridwan, Z. (2020). Effect of fairness and knowledge on tax compliance for Micro, Small, and Medium Enterprises (MSMEs). *International Journal of Research in Business and Social Science* (2147-4478), 9(1), 143-150.

¹¹ Michael Doran, Tax Penalties and Tax Compliance, *Harvard Journal on Legislation*, Vol. 46, 2009, pp. 111-161.

¹² Arindam Das-Gupta, Shanto Ghosh dan Dilip Mookherjee, Tax Administration Reform and Taxpayer Compliance in India, *International Tax and Public Finance*, Vol. 11, 2004, pp. 575–600.

¹³ Katharina Gangl, and Benno Torgler, 2020, How to Achieve Tax Compliance by the Wealthy: A Review of the Literature and Agenda for Policy, *Social Issues and Policy Review* 14: 108–51.

The occurrence of tax avoidance and tax evasion, which has led to a decrease in compliance and not maximizing tax revenue, raises questions about the legitimacy of taxes in Indonesia. The literature on legitimacy shows that in complex fields, including taxation, a lack of knowledge prevents the emergence of distorted judgments and, therefore, inhibits change. At the same time, mechanisms such as media attention, support for criticism, and the creation of crises can disrupt institutionalized practices.¹⁴

Burlea and Popa conceptualize legitimacy theory as a theory that explains the behaviour of organizations in implementing and developing voluntary disclosure of social and environmental information to fulfil their social contract, which allows recognition of their goals and survival in an agitated and turbulent environment.¹⁵ Furthermore, regarding legitimacy theory, Burlea and Popa (2013) suggest the elements that form legitimacy, namely cognitive legitimacy, moral legitimacy, and pragmatic legitimacy, which are influenced by cognitive legitimacy affecting moral legitimacy, moral legitimacy affecting pragmatic legitimacy, and pragmatic legitimacy affecting cognitive legitimacy. Cognitive and moral legitimacy are part of the internal environment, while pragmatic legitimacy is external environment.¹⁶ Cognitive legitimacy refers to the spread of knowledge about a business, where one can assess cognitive legitimacy by measuring the level of public knowledge about an activity.¹⁷ The highest form of cognitive legitimacy is achieved when a product, process or service is acceptable to a society or community.¹⁸ Then, moral legitimacy means universal ethical rules.¹⁹ Meanwhile, pragmatic legitimacy rests on the interests of the closest stakeholders in an organization, which involves broader political, economic, or social interdependencies. Thus, an organization's pragmatic nature cannot be separated from protecting its shareholders' interests.²⁰

The legitimacy theory shows that the tax authority must be able to produce conformity between inherent (or implied) social values and community norms in legitimizing every action or activity. So, in law enforcement that can increase tax compliance and improve the tax ratio, the cognitive legitimacy of this research reaches the law enforcement system in the field of taxation; moral legitimacy refers to tax compliance, and pragmatic legitimacy refers to the tax ratio. The existence of legitimacy theory in improving tax compliance shows that tax payment, which is part of the state obligation of every citizen, cannot be separated from the existence of a good tax system. However, when there is non-compliance in fulfilling tax obligations in the form of tax avoidance and tax evasion, law enforcement in the field of taxation is one of the solutions to handling non-compliance.

¹⁴ Mattia Anesa, Nicole Gillespie, A. Paul Spee, Kerrie Sadiq, *The legitimation of corporate tax minimization*, *Accounting, Organizations and Society*, Vol. 75, Iss C (2019): 17-39, DOI: 10.1016/j.aos.2018.10.004.

¹⁵ Burlea, Adriana Schiopoiu, dan Popa, Ion. (2013), "Legitimacy Theory", dalam Samuel O. Idowu (Editor in Chief), *Encyclopedia of Corporate Social Responsibility*, Heidelberg: Springer-Verlag Berlin Heidelberg, pp. 1579-1584.

¹⁶ Ibid.

¹⁷ Aldrich, H.E., Fiol, C.M., *Fools rush in? The institutional context of industry creation*. *Academy of Management Review*, Vol. 19, No. 4, 1994, hlm. 645-670.

¹⁸ Ibid.

¹⁹ Fred E. Foldvay, *Moral Legitimacy*, dalam Deen K. Chatterjee (Ed.), *Encyclopedia of Global Justice*, New York: Springer Science + Business Media B.V., 2011, pp. 724-725.

²⁰ Muhammad Azizul Islam, Barry J. Cooper, Shamima Haque & Michael John Jones (2022) *Moral versus pragmatic legitimacy and corporate anti-bribery disclosure: evidence from Australia*, *Accounting Forum*, 46:1, 30-56, DOI: 10.1080/01559982.2021.1925037.

Increasing taxpayer compliance is one of the government's important hopes to improve its taxation ratio in the era of implementing a self-assessment system. Increasing taxpayer voluntary compliance is expected to increase tax revenues that can finance development in Indonesia.²¹ Of course, the problem of taxpayer compliance in Indonesia must be addressed immediately, considering the problems faced by the DGT related to the lack of taxpayer compliance. One of the problems in the Indonesian tax system can impact tax revenue and tax ratio because tax non-compliance that causes large amounts of tax evasion has resulted in a very low level of tax revenue.²² The key to reforming the tax system of developing countries in increasing tax revenue is to modernize the system, increase the effectiveness and efficiency of tax collection, expand the tax base, and effectively prevent taxpayer non-compliance.²³

C. Conclusions and Suggestions

Based on the analysis and discussion, this study concludes that the occurrence of tax avoidance and tax evasion that causes a decrease in the level of compliance and not maximizing tax revenue must be handled by strengthening the legitimacy (law) of taxes in Indonesia. Strengthening tax legitimacy in Indonesia must be based on the elements of legitimacy in the form of cognitive legitimacy, moral legitimacy, and pragmatic legitimacy.

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²¹ Anis W. Hermawan, Voluntary Disclosure Program in Taxation and Its Certificates: A Philosophical Perspective, *Journal of Tax Law and Policy*, Vol. 1, No. 2, 2022, hlm. 63–70, DOI: <https://doi.org/10.56282/jtllp.v1i2.119>.

²² Alm, J. (2019). Can Indonesia reform its tax system?: problems and options (No. 1906). (*Tulane University, Department of Economics*).

²³ United Nations Economic and Social Council. (2006). *Definitions of Basic Concepts and Terminologies in Governance and Public Administration*. A Report submitted by the Committee of Experts on Public Administration.

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