

# CHAPTER I

## INTRODUCTION

### 1.1. Background of the Study

Taxes are an important thing in state's life. Taxes are obligated contributions to the state owed by individuals or entities that are compelling and regulated on law, without receiving any direct compensation (Isyrin, 2019). They are also used for state's needs in the interest of the citizens or people's prosperity. The payment of taxes is a manifestation of state obligations and taxpayers' participation in carrying out the tax obligations directly and jointly for state financing and national development (Mardiasmo, 2018).

According to the taxation law's philosophy, paying taxes is not only an obligation, but also a right of every citizen to participate in the state financing and national development. Taxes are an important component of a country's development. Taxes are used to fund a variety of government expenditures. People are required by law to pay taxes to the government. According to the Indonesia's Taxation Law, Number 16 Year 2009, taxes are compulsory contributions to the state owed by private person or entities that are compelling under the law, without receiving direct reciprocity and used for the state's needs for the greatest prosperity of the people (Kusuma, 2019).

Tax is one important part of any country's journey, including Indonesia's. Taxes have existed for a long time in Indonesia, as well. Taxes have existed in Indonesia since the days of kingdom, but with a different collection system. In the past days of the kingdom until the colonialism, levies were really compelling. In the days of the kingdom, the levy was paid as a tribute to the king, who was regarded as God's representative (Sarip, 2017). The people who pay the levies were treated fairly.

The people were given guarantees and orders from the king, and some kingdoms even implemented a tax system, particularly on cultivated land, at the time (Sugiyarto et al., 2020). As Indonesia entered the colonial era, taxes were imposed in Indonesia. Home taxes, business taxes, land rent taxes, and merchant taxes are some of the taxes that were levied. People are made to feel heavy and burdened by the existence of this system. Furthermore, there was no clarity at the time, and the colonial government committed numerous abuses.

In fact, state income is derived from its people through the tax collection and/or from the results of the natural resources within the country. These are the two most important sources of revenue for the government. The income is used to fund the public good, which ultimately includes individual personal interests such as health, education, and welfare. So, taxation is one important revenue for the country. No

government function will run well if the taxpayer doesn't have an obligation to pay taxes (Fadhilah, 2018).

As time goes by, the existence of taxes is felt more and more important. This make the government sets the tax revenue targets every year in hope that taxpayers compliance are increasing. In result, state revenue from the tax sector continues to increase from year to year (Arum, 2012). This increase is expected to be able to meet the needs of the country's development as well as overcome Indonesia's economic problems, ensuring that the welfare of the Indonesian people improves and doesn't left behind other countries. According to the Central Government Financial Report data Year 2018 Ministry of Finance, the domestic tax revenues achieved is 93.8% or 1,518.8 Trillion of the predetermined budget which is 1,618.1 Trillion (Kemenkeu, 2018).

Due to the large portion of the state budget, the government has a duty in maximizing the tax revenue. The government, particularly the Directorate General of Taxes, continues to strive for increased tax revenue. The Directorate General of Taxes has made various efforts to maximize tax revenue, including tax inflation, tax intensification, new tax objects, and tax intensification by optimizing the call for taxpayers. Moreover, the government must improve the effectiveness of inspection and billing, implement tax reform consistently and sustainably, and provide better services to taxpayers in the form of easy reporting, payments, and access to tax information (Fadhilah, 2018).

The Directorate General of Taxes has made efforts to maximize tax revenue, but it also requires taxpayer awareness and participation in order for potential tax revenues to be collected effectively and efficiently. When it comes to taxation, Indonesia is a country that adheres a self-assessment tax system. This means that taxpayers can calculate, deposit, and report their own tax obligations with confidence by themselves. This system, however, will only work if taxpayers have a thorough understanding of taxation and use it to fulfill their tax obligations (Suryanti and Sari, 2018).

The self-assessment system, according to Resmi (2008), is a tax collection system that allows taxpayers to determine the amount of tax due each year in accordance with applicable tax laws. The tax administration plays an active role in the self-assessment system, fostering, supervising, and imposing sanctions on deferred tax obligations in accordance with the provisions of tax regulations. The supervisory function is critical because it cannot function properly without it in the face of low taxpayer compliance.

As a country that adopts a self-assessment system, tax compliance is one of the most important factors in the revenue and implementation of tax obligations for Indonesia. It is because under the self-assessment system, the government trusts taxpayers to calculate, deposit, and report their own tax obligations. In the implementation of the self-assessment system, taxpayer compliance in fulfilling their tax obligations is very important because taxpayers are responsible for placing the amount of tax

owed themselves and then accurately and timely reporting and paying the stated tax (Aini and Fidiana, 2017).

Tax compliance is a common issue for tax authorities all over the world. For a long time, tax authorities have been concerned about efforts to improve tax compliance. Tax compliance can be defined as the willingness of taxpayers to follow a country's tax regulations (Andreoni, et.al., 1998). Tax compliance refers to a taxpayer's ability and willingness to comply with tax regulations, report income correctly, and pay taxes correctly and on time.

Taxpayer compliance can also be defined as a taxpayer's attitude or behavior in carrying out all of his/her tax obligations and exercising all of his/her tax rights in accordance with the provisions of the applicable law. According to (Rustiyaningsih, 2011), the government is still attempting to improve taxpayer compliance in terms of Annual Tax Return submission, tax payment accuracy, and calculation/reporting, all of which should be improved in order to increase state revenue from the tax sector. Low compliance has a number of negative consequences, including a decline in the country's acceptance due to the loss of potential state revenues, the tax system becoming less prospective, and the tax system becoming less reliable as a source of income.

Unfortunately, the level of taxpayer compliance in Indonesia is quite low, according to the Minister of Finance, Sri Mulyani Indrawati (Kemenkeu, 2018). Whereas, the development and quality of public

services is highly dependent on the revenue collected by the country, which comes from taxation. The tax revenue received by Indonesia is still below the average line. For example, in 2016, Indonesia only collected 14.1% state revenue and spent 16.6% of Indonesia's GDP. It was quite low if we compared to other countries. For example, China was able to collect its state revenue by 27%, while Germany collected 44% of its GDP. (Kemenkeu, 2018).

In addition, according to The Minister of Finance, the tax ratio towards the Gross Domestic Product (GDP) has decreased in the last five years (Intan, 2021). Febrio Kacaribu, the head of the Ministry of Finance's Fiscal Policy Agency (*Badan Kebijakan Fiskal or BKF*), explained that the tax ratio includes both taxes and customs. He stated that the tax ratio has continued to fall over the last five years, forcing them to consider how they can better align their taxation with the economy's structure (Intan, 2021).

**Table 1.1. Indonesia's Tax Revenue Contribution towards the GDP from year 2016 – 2020**

(Intan, 2021)	2016	2017	2018	2019	2020
Tax Revenue Percentages	10.37 %	9.89 %	10.24 %	9.76 %	8.33 %

Source : Intan (2021)

The Minister of Finance really regretted this condition, where there were still many parties who complained the Government's imposition of taxes. More people will become free riders who enjoy state facilities without contributing, as a result of fewer people in paying taxes (Kemenkeu, 2018). Society then demanded the government to provide

facilities and a standard of living with the comparison with other developed countries. In fact, in other developed countries like for example Finland, Switzerland, Norway and Denmark, their people pay taxes up to 70% of their income. As a result, the governments in these countries are able to provide lots of facilities such as free birth, education, and death services from their people's contributions (Kemenkeu, 2018).

The Minister of Finance is constantly enacting tax reforms in order to improve citizen compliance in paying taxes and to improve the database of taxpayers in Indonesia. There are several policies that have recently been implemented which are the tax amnesty year 2016 and cooperation between countries through the Automatic Exchange of Information System (AEOI) which aims to track tax evaders abroad (Kemenkeu, 2018).

The Directorate General of Taxes of North Sumatra I (DJP Sumut I) reported that the compliance of annual tax return reporting at the Regional Office (*Kantor Wilayah* or *Kanwil*) of DJP Sumut I was only 68.16% in 2020 (Manik, 2021). This percentage decreased by 17.55 points compared to the compliance in the year 2019 which was 85.71% of the total taxpayers. However, the number of taxpayers who submitted the annual tax return in 2020 is much larger than 2019, which is about 300% more.

**Table 1.2. The Compliance of Annual Tax Reporting at DJP Sumut I from year 2018 – 2020**

<b>Year</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
Taxpayer who reported their Annual Tax Return (SPT)	75,941	102,000	328,808
Number of taxpayers	101,255	119,979	475,102
Percentage of taxpayers who reported their Annual Tax Return (SPT)	75%	85.71%	68.16%

Source : Manik (2021)

The number of taxpayers were increasing compared from year 2018 to 2019. Thus, in 2019, the compliance was also increased and higher than 2018. From this result, the taxpayer compliance was wished to increase in year 2020. But, it resulted decrease. It was probably happened because of the Covid-19 pandemic (Manik, 2021). Before the pandemic, taxpayers could freely consult with the tax office. In the pandemic situation, the taxpayers couldn't come freely to consult with the tax office's employees where this condition was believed resulted the decrease of the taxpayers compliance in reporting their annual tax return.

There are several factors that can influence taxpayers compliance in fulfilling their tax obligations such as knowledge of the the importance and benefits of the taxation itself, awareness of taxpayers in reporting and paying taxes owed and sanctions or penalties that can be obtained if taxpayers don't comply with the taxes. Tax knowledge is the ability of a taxpayer to understand his/her rights and obligations as a taxpayer to comply with the taxation and in order to avoid tax penalties (Rahayu, 2017). Knowledge is very important in improving the taxpayers compliance because how can people pay taxes if they don't understand the importance and benefit of the taxes.

Tax knowledge, according to Khasanah & Novi (2013) is knowledge about the concept of general provisions in the field of taxation. The types of taxes that apply in Indonesia range from tax subject, tax object, tax rate, tax payable calculation, tax payable recording, and how to fill out tax reporting forms. Lack of socialization is one factor in low tax knowledge because many taxpayers still don't understand the importance of taxes to the state, resulting in lack of contributions in taxpayer compliance.

Research conducted by (Setiyani et al., 2018) found that the tax knowledge has a positive and significant influence on individual taxpayers at the Tax Service Office (*KPP Pratama*) in the Semarang City. Taxpayer compliance can be improved by having a high level of knowledge about the procedures for fulfilling tax obligations, as well as the functions and roles of taxes. This is in line with the theory stated by Ginting et al. (2017), that the higher the level of education or knowledge of taxpayers, the more possibility for taxpayers to meet their tax obligations.

Taxpayer awareness is a factor that comes from the taxpayer's own motivation to fulfill tax obligations honestly and without any duress. It is a condition where taxpayers are aware of, understand, and apply tax provisions correctly and willingly (Mutia, 2014). Society must understand that the taxes they pay will be used to fund government spending to improve people's lives. The level of public awareness in reporting their

taxes has an impact on tax compliance, so the higher the level of awareness, the higher the level of tax compliance will be.

According to Mutia (2014), the public must be aware of the need that comes from within the taxpayer himself about the meaning and benefits of tax collection, and that the obligation to pay taxes is not for other parties, but to smooth the running of the wheels of government that takes care of all of the community's needs. As a result, taxpayer awareness of their obligations to meet tax obligations in accordance with applicable regulations is critical to the taxation system's success. According to research conducted by (Dewi and Merkusiwati, 2018), the level of awareness had a positive effect on compliance with individual taxpayer reporting in the Tax Service Office (*KPP Pratama*) East Denpasar.

Tax sanctions ensure that the law's provisions are followed. In other words, tax sanctions act as a deterrent to ensure taxpayers don't break the law (Mardiasmo, 2018). The imposition of tax penalties is used to ensure that taxpayers comply with their tax obligations. Sanctions in taxation consist of administrative sanctions which include fines, interest, and increases, as well as criminal sanctions for taxation, such as violation and criminal sanctions (Sutedi, 2011). As a result, it is expected that taxpayers will follow tax regulations. If a taxpayer believes that tax penalties will be imposed and be harmful, he/she will comply with his/her obligations.

For creating the good taxation fulfilled by taxpayers orderly, tax sanctions are formed for tax violators. The sanctions are also used by the government to identify taxpayers who break the rules. It means that if tax obligations are not met, legal consequences may result. The government, in this case the Directorate General of Taxes, enacts tax-related legislation, including penalties imposed on taxpayers who break the rules.

Tax sanctions are believed to have a positive effect on taxpayer compliance. According to research conducted (As'ari and Erawati, 2018), tax sanctions have a positive and significant to individual taxpayers compliance in Kecamatan Rongkop. But in contrast, research conducted by Ningsih and Rahayu (2016), tax sanctions has no impact on taxpayer compliance. This case demonstrates that tax penalties are still ineffective in getting taxpayers to comply with their tax obligations.

Beside these three factors, there are many other things that can influence the taxpayers compliance. Thus, the writer would like to know more about these three factors whether they influence the individual taxpayers' compliance in this study. This study of research will be done in Kelurahan Tegal Sari I Medan. The writer would like to know how the people in this area perceive taxation and whether the three factors influence their compliance.

From the explanation above, it can be seen that the level of individual taxpayers in Indonesia, especially in Medan, North Sumatra. The decrease of the compliance level is considered because of the

pandemic situation that is happening which surely impact and burden people. But, even though people is experiencing hard times these days, the obligation of complying taxes can't be ignored. The government also try their best by using these tax revenues to cure and help the people.

Kelurahan Tegal Sari I Medan is an area located in Kecamatan Medan Area, Medan, North Sumatra, Indonesia. Based on the preliminary research conducted by the writer through an informal interview with the few citizens who are living in this area, the writer finds out that some of them admitted for not paying and reporting their tax payment. Other than that, the writer is currently residing in this area, therefore the writer is interested to do further research to know about the taxpayers' compliance in this area.

The writer would like to know whether the people in this area are good citizens who fulfill their obligations in paying the taxes. And based on the previous research, the writer chooses the title **“The Influence of Tax Knowledge, Tax Awareness, and Tax Sanctions Towards Individual Taxpayers' Compliance in Kelurahan Tegal Sari I Medan”**.

## **1.2. Problem Limitation**

The problem limitation of this study is the Tax Knowledge, Tax Awareness, Tax Sanctions and Individual Taxpayers' Compliance. The independent variables which will be researched in this study are tax

knowledge, tax awareness and tax sanctions. While the dependent variable is individual taxpayers' compliance. The research object in this study will be the people who are individual taxpayers and live in Kelurahan Tegal Sari I, Kecamatan Medan Area, Medan, North Sumatra. This study will focused on the research of whether the independent variables affect the dependent variable in the research area. The research is done in the area by the writer within approximately two weeks which is from August 20, 2021 until September 2, 2021. The observation process of this study is done in several months which is from July 2021 to October 2021.

### **1.3. Problem Formulation**

The problem formulation of this study are as follows :

1. Does tax knowledge significantly influence the individual taxpayers' compliance in Kelurahan Tegal Sari I Medan ?
2. Does tax awareness significantly influence the individual taxpayers' compliance in Kelurahan Tegal Sari I Medan ?
3. Does tax sanctions significantly influence the individual taxpayers' compliance in Kelurahan Tegal Sari I Medan ?
4. Does tax knowledge, tax awareness and tax sanctions significantly and simultaneously influence the individual taxpayers' compliance in Kelurahan Tegal Sari I Medan ?

#### **1.4. Objective of the Research**

The objective of this research are as follows :

1. To determine whether the tax knowledge influence the individual taxpayers' compliance in Kelurahan Tegal Sari I Medan.
2. To determine whether the tax awareness influence the individual taxpayers' compliance in Kelurahan Tegal Sari I Medan.
3. To determine whether the tax sanctions influence the individual taxpayers' compliance in Kelurahan Tegal Sari I Medan.
4. To determine whether the tax knowledge, tax awareness and tax sanctions simultaneously influence the individual taxpayers' compliance in Kelurahan Tegal Sari I Medan.

#### **1.5. Benefit of the Research**

The benefit of this research is divided into two, namely theoretical and practical benefit.

##### **1.5.1. Theoretical Benefit**

The theoretical benefits of this research are as follows :

1. For the writer

This research is expected to add knowledge and insights in the field of taxation, especially on the issue of tax knowledge, tax awareness, tax sanctions and individual taxpayers' compliance.

## 2. For the individual taxpayers

This research is expected to add understanding and knowledge about the importance of taxation which is beneficial for lives and increasing their compliance level.

## 3. For the government

This research is expected to give insights to the regulators to know about the influences of the several factors in improving and increasing the tax revenue.

### **1.5.2. Practical Benefit**

The practical benefits of this research are as follows :

1. Provide an overview about the influence of tax knowledge, tax awareness and tax sanctions towards the individual taxpayers' compliance in the research area.
2. Give insights and understanding to individual taxpayers about the importance of fulfilling their tax obligations and the benefits of it.
3. As a reference for further research relating to the influence of tax knowledge, tax awareness and tax sanctions on individual taxpayers' compliance