

Why is Tax Knowledge and Tax Understanding Important?

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ABSTRACT

Micro, small, and medium (MSMEs) business play a crucial role in the economy of Indonesia. Unfortunately, there is low-income tax receipt from MSME sectors. This study examined the effect of taxation knowledge and understanding toward tax compliance among MSMEs owners, exclusively culinary business owners. The quantitative method was used in analyzing the data collected. The sample size for the research was 50, with all MSME owners responded through the questionnaire distributed. This study concluded that there is a positive effect between taxation knowledge and level of understanding toward tax compliance. It means that an increase in tax knowledge and tax understanding level can lead to an increase of tax compliance level. Although this study succeeded to prove the effect between variables, the results of secondary data indicate that many MSME owners are still confused in implementing tax regulations, PP-23/2018.

Keywords: Tax Compliance; Tax Knowledge; Level of Understanding; MSME

1. INTRODUCTION

1.1 Research Background

Taxation is the primary source of income for a state. The tax collection target that amounted IDR 1.42 Quadrillion in 2018 made the government make various tax regulations that will affect positively and negatively to multiple economy sectors, including MSMEs sector. MSMEs itself play a crucial role in the economy of Indonesia. They are expected to be a backbone of the government income through regional taxes and levies. MSMEs that run either by individuals or entities have an obligation to pay taxes in Indonesia. In addition to their duties as self-assessment, taxpayers are also obliged to cut and collect taxes (Susyanti & Dahlan, 2016). Unfortunately, the increasing number of MSMEs entrepreneurs did not affect the tax contribution (Susyanti, 2014). There are several factors that influences tax compliance including referral groups, the probability of audit, tax knowledge, and the perception of equity and fairness (Inasius, 2018), tax education (Kwok & Yip, 2018; Aladejebi, 2018), political factors, such as lack of transparency due to weak news media, sociological, cultural factors, such as weak national identity (Bessley & Persson, 2014), level of understanding (Adiasa, 2013; Agustiniingsih & Isroah, 2016), lack of adequate knowledges (Fallan, 1999; Omagor & Mubiru, 2008; Manual & Xin, 2016; Newman, Charity, & Ongayi, 2018). Susyanti (2014) argues that the lack of tax knowledge and understanding of MSMEs owners is the main detention in fulfilling tax obligations. Therefore, it is necessary. Therefore, there is a need to continually grow public awareness and compliance of taxpayers to fulfill tax obligations in accordance with applicable regulations.

1.2 Research Problem

- a) How is the effect of taxation knowledge and taxation understanding on tax compliance simultaneously?
- b) How is the effect of taxation knowledge and taxation understanding on tax compliance partially?



1.3 Research Purpose

The purpose of the study was to understand and analyze the effect of taxation knowledge and taxation understanding on tax compliance both simultaneously and partially.

2. THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

2.1 The Effect Between Tax Knowledge and Tax Compliance

Tax knowledge, in a simple term, can be defined as the taxpayer ability to understand the tax laws and regulations (Ayuba, Saad, & Arifin, 2016). Pratama (2018) added that tax knowledge is a level of knowledge of basic tax concept that consists of tax rules and financial knowledge that needs to be understood by taxpayers in order to fulfill their tax obligations (Pratama, 2018). Gore & Wong (1998) divided tax knowledge into categories, procedural knowledge (knowing how) and declarative knowledge (knowing that). Previous research from Fallan (1999), Omagor & Mubiru, (2008), Manual & Xin (2016), Newman, Charity, & Ongayi (2018) concluded that there is a relationship between tax knowledge and tax compliance, an increase of tax knowledge level can lead to the increase of tax compliance level.

2.2 The Effect Between Tax Understanding and Tax Compliance

Sulistiani, & Jayanto (2016) defined tax understanding as to the understanding or knowledge possessed by the taxpayer related to taxation. Satria (2017) added that tax understanding is the perception of taxpayer toward their knowledge about taxation. Tax understanding is the level of knowledge and ability of taxpayers concerning the enactment and the implementing regulations of the tax law both in content and administration. Previous research from Adiasa (2013), Agustiningih & Isroah (2016) concluded there is a relationship between tax understanding and tax compliances. Thus, the higher tax understanding can lead to higher compliance.

Therefore, the hypothesis proposed in this study is;

- H₁: Tax knowledge and tax understanding have a partial significant effect toward tax compliance.
H₂: Tax knowledge and tax understanding have a simultaneous significant effect toward tax compliance.

3. RESEARCH METHOD

3.1 Research Design

This study can be classified as quantitative descriptive research. The primary data collection technique was done by giving questionnaires to respondents. While the secondary data collection technique was done through recording, documents related to the business profile and the types of activities. Based on the questionnaire feedback, it can be determined (measured) the frequency distribution for each variable, so that it can be known whether the intention to comply tax is good (indicated by high score) or poor (indicated by low scores). Tarigan (2012) determined the formula as follows;

$$\text{Range} = \frac{(\text{highest score} - \text{lowest score})}{\text{number of answer categories}} = \frac{(5 - 1)}{5} = 0,8$$



Table 1 Respondent Perception Levels

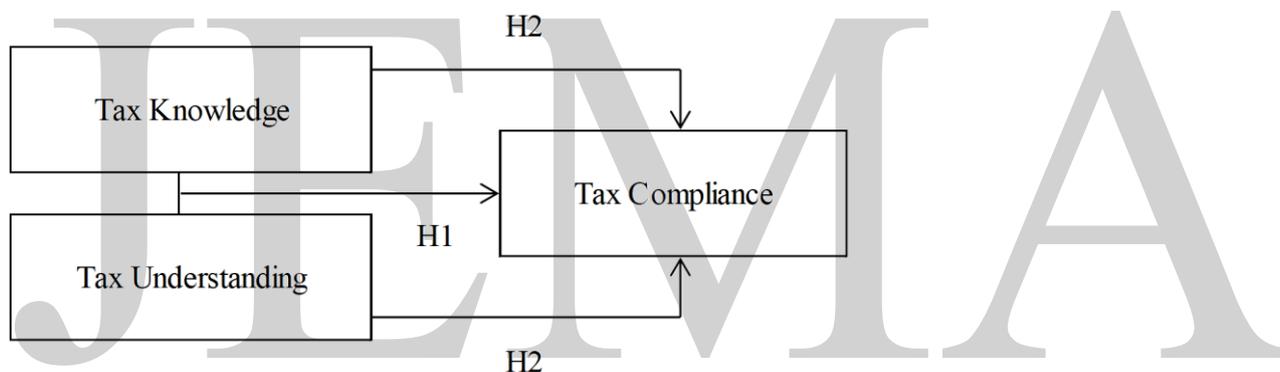
Mean Range of Respondent's Answer Scores	Respondent's Perception Level
1,00 – 1,80	Very bad
1,81 – 2,60	Bad
2,61 – 3,40	Good Enough
3,41 – 4,20	Good
4,21 – 5,00	Very good

Source: Tarigan (2012)

3.2 Population and Sample

The population in this study is the MSME owners in Malang, East Java, Indonesia, exclusively culinary industry. The reason in choosing culinary industry and Malang as a research subject is because those subjects are recorded strong growth and contribute quite significantly to the total income of the tourism sector and the creative economy last year. All population or 50 culinary owners in Malang participate in this study.

3.3 Research Framework



Picture 1 Research Framework

4. RESEARCH RESULT AND ANALYSIS

4.1 Descriptive Analysis

The culinary owners who have a thematic culinary service business were 54% while culinary owners that have their owned unique product was 46%. Female is the majority of the respondent in this study (52%) with most of the culinary business were driven by young people.

According to Rachmawati (2017), the business is categorized as a micro business if it has a maximum total revenue of IDR 500 million. While the small business has total revenue between IDR 500 million - 2.5 billion, the medium business has total revenue beyond IDR 2.5 billion. Table 2 described that the majority of the respondent in this study got maximum IDR 1.000.000.000 for total revenue, it means that this sector has the potential to become a powerful force to encourage total income of the tourism sector and the creative economy shortly.

Table 2 Culinary Business Total Revenue

No	Total Revenue	Total Owner	Percentage
1	≤ IDR 500.000.000	16	32%
2	IDR 500.000.001-1.000.000.000	10	20%
3	IDR 1.000.000.001-1.500.000.000	7	14%
4	IDR 1.500.000.001-2.000.000.000	8	16%
5	IDR 2.000.000.001-2.500.000.000	5	10%
6	IDR 2.500.000.000 and above	4	8%
	Total	50	100%

Source: Primary Data Processed, 2018

Based on Table 3, it was found that the respondent has a good enough perception (3,24) to the procedures in paying taxes. Uniquely, the respondent has a poor perception (2,16) about the function and benefits of Tax Identification Number (NPWP).

Table 3 Mean Score of Taxation Knowledge

No	Questionnaire	Mean	Decision
1	I know the general understanding of taxes, NPWP, WPOP, Corporate WP, Entrepreneurs, and SPT.	3,00	Good Enough
2	I know how the procedure for paying taxes.	3,24	Good Enough
3	I know the function and benefits of the Tax Identification Number.	2,16	Bad
4	I know the tax collection, the basis of tax collection and may or not the taxpayer pay it in installments.	3,18	Good Enough
5	I know the basic of accountancy and recording, which must be done by taxpayers in general.	3,12	Good Enough

Source: Primary Data Processed, 2018

Meanwhile, Table 4 shows that the respondent had good enough perceptions of all questionnaire item in tax understanding. They know what is the general provisions of taxation, tax deposits, and tax reporting about. They also know how to fill and calculating tax.

Table 4 Mean Score of Tax Understanding

No	Questionnaire	Mean	Decision
1	I understand the general provisions of taxation.	3,10	Good Enough
2	I understand how to fill SPT.	3,22	Good Enough
3	I understand the calculation of tax.	3,24	Good Enough
4	I understand tax deposits.	3,28	Good Enough
5	I understand tax reporting.	3,24	Good Enough

Source: Primary Data Processed, 2018

A result from Table 5 indicates that they do not agree with the questionnaire item that states that they registered tax identification number voluntary, and they recorded financial business regularly and consistently.

Table 5 Mean Score of Tax Compliance

No	Questionnaire	Mean	Decision
1	I registered the NPWP voluntarily.	2,32	Bad
2	I record the financial business regularly and correctly.	2,70	Bad
3	I fill out, count, and report tax notification letters honestly, completely, and correctly in accordance with applicable rules.	3,32	Good Enough
4	I pay taxes voluntarily according to the rules and on time.	3,18	Good Enough
5	I consciously carry out enforcement of taxation sanctions.	2,96	Bad

Source: Primary Data Processed, 2018

4.2 Validity and Reliability

The validity test of the questionnaire was conducted in order to determine the validity of the questionnaire. All constructs of the question in this study can be categorized as a valid and reliable because of they significant in 0,05 ($r\text{-value} > r\text{-table}$) and greater than 0,60 for Cronbach Alpha rule.

4.3 Research Analysis

The best-fit regression model should fulfill the following classic assumptions, including:

a. Multicollinearity

Based on Table 6, it can be seen that all variables have Tolerance $> 0,10$ and VIF value < 10 , thus it can be concluded that the regression model does not have a multicollinearity problem.

Table 6 Multicollinearity Test Results

Variable	Collinearity Statistics	
	Tolerance	VIF
Tax Knowledge	0,949	1,053
Tax Understanding	0,956	1,046

Source: Primary Data Processed, 2018

b. Autocorrelation

The result of the Durbin Watson test is 1,905, which is greater than -2 and smaller than +2, it means there is no autocorrelation in the regression model.

c. Heteroscedasticity

The result of the Park test shows that there is no significant result between tax knowledge, tax understanding, and its unstandardized residual ($\text{Ln}U_i^2$). Therefore, it concluded that there are no symptoms of heteroscedasticity from this regression model.



d. Normality

Based on the results of the Kolmogorov Smirnov Test (KST), the significance value of the variable is 0,524, which is greater than $> 0,05$. It means that the regression model is normally distributed.

Tabel 2 Regression Result

Variable	Regression Coefficient	t_{test}	Sig.	Decision
Tax Knowledge (X_1)	0,959	2,158	0,000	Significant
Tax Understanding (X_2)	0,054	0,49	0,027	Significant
Constant		1,597		
R		0,954		
R square		0,910		
Adjusted R square		0,907		
F_{test}		23,89		
Sig. F		0,00		
N		50		
F table		3,20		
t table		1,67		
Dependent Variable		Tax Compliance (Y)		

Source: Primary Data Processed, 2018

Based on the regression results, the tax knowledge and tax understanding have a partially significant effect on tax compliance because of their significant value that below 0,05 (0,000 and 0,027). This study also concludes that tax knowledge and tax understanding has a significant simultaneous effect on tax compliance because they're a significance value below 0,05 (0,00). The results of this analysis were strengthened by obtaining the value of the adjusted R square (R^2) of 0,907 or 90,7%. It means that tax knowledge and tax understanding can explain 90,7% of tax compliance. While the remaining 9,3% was influenced by other variables that are not included in this model.

4.4 Research Discussion

The problem of tax compliance is as old as taxes themselves, especially in developing countries like Indonesia (Besley & Persson, 2014). The result of this study supports previous research conclusion which states that there is the relationship between tax knowledge, tax understanding, and tax compliance both partially and simultaneously (Fallan, 1999; Omagor & Mubiru, 2008; Newman, Charity, & Ongayi, 2018; Kwok & Yip, 2018; Aladejebi, 2018). There is no difference perception between male and female in perceived the importance of tax knowledge and understanding. Surprisingly, although the majority of the respondent in this study has a relatively positive perception about the importance of tax knowledge and understanding item questionnaire, they have low responses in perceiving tax compliance. Susyanti (2014) argues that many MSMEs owners are still confused in implementing tax regulations; PP-23/2018, they only know the tax knowledge and tax understanding in general or average way. Therefore, it is suggested that tax education should begin in the early stages of level education such as school (Palil, Akir, &



Ahmad, 2013). Hopefully, if the employees had adequate tax knowledge, there would minimize the unintentional non-compliances.

5. RESEARCH CONCLUSION AND LIMITATION

5.1 Conclusion

The result of this study is not difference with another previous study. This study concluded that there is an effect of tax knowledge and tax understanding toward tax compliance, both partially and simultaneously. It means that to enhance the level of tax compliance, stakeholder should increase the knowledge and the level of understanding of the taxpayer. Interestingly, although this study succeeded to prove the effect between variables, the results of secondary data indicate that many MSME owners are still confused in implementing tax regulations, PP-23/2018.

5.2 Limitation

The limitation of this study is that the data collection used is only questionnaires based. It means that this research only covered the perceptions of respondents and did not describe the actual situation of respondents. This study also used a limited sample, so the results cannot be generalized. Future research should be done in another type of business and variables.

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