

# Determination Analysis on Taxes Compliance of SMEs: Case Study in Tangerang, Indonesia

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**Abstract**—This paper examines the effects of financial conditions, types, and size on tax compliance of SMEs in Tangerang with a reduction in tax rates (Tax Facilities) as a moderating variable. The population are SMEs located in Bintaro, South Tangerang. Out of total, 70 SMEs were chosen by using purposive sampling as confirmed respondents. The data was collected by distributing questionnaires to the respondents. Hypothesis testing was conducted by using multiple linear regression methods. The results showed that partially the financial condition and size of a SME did not affect taxpayer compliance. On the other hand, the type of a SME affects taxpayer compliance. Simultaneously, the financial condition, type, and size of the SMEs taxpayer compliance in Bintaro with a decrease in tax rates as an influential moderating variable. This paper has recommended the adobtion of larger and more focused questionnaires such as selecting potential respondents who have been recorded by the SMEs ministry and on a wider scale, such as covering 5 big cities or even from all provinces in Indonesia or compare to other developing country such as Malaysia, Philipina and Vietnam.

**Keywords**—*Financial Condition, Type, Size, Taxpayer Compliance, and Tax Facilities.*

## I. INTRODUCTION

The role of Micro, Small and Medium Enterprises (SMEs) in the national economy is calculated to be quite large. This number reaches 99.9 percent and employment reaches 97 percent (Putra, 2018) [1]. If the society expects SMEs not to pay tax, SME tax payers might not pay taxes following such societal expectations. It is reasonable to suggest that to improve tax compliance, these forces should support tax paying predispositions. This line of thinking suggests that SME tax compliance behaviours can be described in terms of isomorphism shaped by institutional pressures and expectations. Institutional theory (DiMaggio and Powell, 1983) [2] suggests that SME tax compliance behaviour responds to the pressures from general social expectations and the actions of other similarly situated organizations (Chizema and Buck, 2006) [3]. But, rather than providing direct assistance to smaller firms, government should concentrate on creating a business environment conducive to small and medium business growth, and promoting provision of business development services by the private sector (Albert et al, 2001) [4].

SMEs can be distinguished by size, industrial sector and owner motivation. Therefore, they cannot be used as one measure for all the provisions of services and policy formulations. Although understanding management techniques relevant to large companies may not necessarily

be applied to small companies, accordingly or vice versa, fundamentally accounting records and financial awareness are essential for the survival of SMEs, stated by Kurniawan & Haryanti (2016) [5]. The types of SMEs, according to Law Number 20 of 2008, are micro businesses, small businesses, and medium enterprises. Each of them has its own criteria which can be seen from various aspects, both in terms of wealth owned by business actors, the number of workers owned or in terms of sales/turnover of SME actors.

The size of the company is a scale that classified group companies into large and small companies, according to various ways, such as examples, the size of the company we can see through the total assets of the company owned and indicated by the log total assets (Machfoedz, 1994) [6], (Yogiyanto, 2007) [7]. Accordingly, the lack of literature that examines the tax compliance of SMEs is associated with a reduction in tariffs, making this research important to be conducted, especially in relation to the size of the SMEs. The research problems aim to find the answer of whether financial condition, SMEs type, company size and tax tariff reduction influence to tax compliance.

## II. LITERATURE REVIEW AND HYPOTHESIS FORMULATION

Winieki et al. (2004, pp. 94-95) [8] comments on the fact that the size structure in the EU is dominated by small firms, yet there still remain a gap to be filled by future expansion in SMEs. The jump-start of SME's in East-Central Europe was one of the most important developments in post-communist transition, however the development of SME's has not yet reached other high growth countries. Within the overall business environment, the legal environment (of which taxation is an integral part) is a crucial factor in sustaining and developing the SME sector. This was a point mentioned (early in the post-communist transition process to a market economy) by Koves (1992) [9] and it is possible to use either an authorised person or a tax representative for the procedure (Estonian Tax and Customs Board, 2010[10]), where the taxation regulations are continually changing SMEs have transaction costs in leaving and entering a new system. Estonia negotiated heavily with the EU to keep its very simple and entrepreneurial friendly system of taxation and once changed this system has basically remained the same which has unquestionably helped SME's (Quartey 2001 [11], Ollington and Reuid 2004) [12].

The better the financial condition of taxpayers, the higher the level of taxpayer compliance and the lower the

financial condition of the taxpayer, the lower the level of taxpayer compliance. The financial condition of taxpayers does not have a significant effect on the relationship between taxpayer's perceptions of the quality of tax services. Taxpayer compliance and has a positive effect on taxpayer requirements (Monica, 2013) [13], Prayatni and Jati (2016) [14].

### III. METHODOLOGY

The questionnaire for the data collection was adopted from previous study conducted by Mistry (2014) [15]. The questionnaire was distributed in printed and online version. This study is conducted to test the validity and reliability of the list used in the questionnaire. After the data are confirmed valid and reliable, descriptive statistical analysis is carried out as the instrument to describe the data statistically and normality test used the Kolmogorov-Smirnov Test Statistical Packages for Social Science (SPSS) method by using t and F test.

### IV. RESULT AND ANALYSIS

There were 70 SMEs (about 70 per cent of response). Usable questionnaires were obtained from 100 respondents, 55 female respondents (78.6%) and 15 male respondents (21.4%). The Financial Condition of SMEs in the Tangerang have a good financial condition, the type of SME in the Bintaro area is well distributed. Size works well as a variable used in this study, Decrease in Tax Rates, where this variable is a moderating variable proves that there has been a lot of information about the reduction in SME tax rates, because the mean value of 0.63 is approaching the maximum value of 1, and the Taxpayer Compliance in the Tangerang - Bintaro works well.

### V. DISCUSSION

The results of testing the hypothesis regarding the financial condition of taxpayer compliance shows the value of t count of 0.882 with a significance value of  $0.381 > 0.05$ , which means that the financial condition does not significantly influence taxpayer compliance. **Thus (H1) is rejected.** Even though financial condition is theoretically the company's financial capability reflected in the level of profitability and cash flow that has been proven to be one of the factors that influence compliance in complying with tax regulations because profitability will pressure someone to report their t (Bradley, 1994) [16]. Good financial condition are internal factors that will shape aspects of individual behavior, namely tax compliance. If there are internal factors, namely the financial condition will result in behavior arising from the taxpayer, namely compliance with paying taxes (Rabsanjani, 2018) [17]. However, this study indicates other conditions that the financial condition does not affect taxpayer compliance. A company having high level profitability does not guarantee a good liquidity as the profitability ratios are calculated from accounting profits divided by investment, assets, or equity, where accounting earnings adhere to the accrual basis. Therefore, to measure the company's financial condition, in addition to profitability, cash flow is another important measure. Likewise companies that experience difficulties in liquidity

is likely not to comply with tax regulations in an effort to maintain its cash flow (Monica, 2013) [13].

Febrianti (2014) [18], Monica (2013) [13], Estiningsih (2014) [19], stated that perceptions about the financial condition of personal taxpayers did not significantly influence individual taxpayer compliance. The financial condition of taxpayers did not have a significant positive effect on the relationship between taxpayer perceptions about the quality of tax services and tax compliance. This is also reflected in the increase in profits and cash flow does not affect compliance with tax obligations. The result showed that companies with low profitability tend not to report taxes honestly, low profitability business entities usually experience financial difficulties and have a tendency to not comply in fulfilling their tax obligations. As well companies that experience liquidity difficulties are found to be likely not to comply with tax rules in an effort to maintain cash flow. This study reveals that the type of company negatively affects taxpayer compliance (**H2 is accepted**), the level of profitability may not be able to determine the taxpayers in fulfilling his tax obligations as they have the tendency to maintain their cash flow. Suryadi (2006) [20], states that the larger taxpayers are more aware of taxation than small taxpayers and different types of companies will affect ability generate disclosed profits. The types of SMEs can be seen from the net assets owned and sales generated in a tax year which can be grouped into micro, small and medium (Law No. 20 of 2008). Type of company had no significant effect on taxpayer compliance, and the types of companies in the form of manufacturing and non-manufacturing do not become the influence of the taxpayer to pay the tax burden. The negative coefficient means that there is a reverse correlation between the variable type of SMEs and the level of compliance paying taxes. Thus, it can be concluded that the higher the type of SMEs the more obedient they are (Hany and Lubis, 2014) [21].

The results proves that when companies grow, they tend to ignore the tax obligations, as large companies have supporting resources for earning management. Thus, they tend to be able to carry out tax evasion. Earnings management, according to Scott (1997) [22], is management intervention in the process of preparing financial statements for external parties so that it can flatten, increase, and reduce earnings reporting, where management can use the leeway of using accounting methods, making policies (discretionary) that can accelerate or delay costs and income, so that the company's profits are smaller or larger as expected. Small company profits that will ultimately affect the amount of tax that will be issued. Thusn it can be said that the type of SMEs is also not a determinant of compliance to pay taxes. There are still many variables that can determine the taxpayer's compliance other than types of SMEs. In this research, size does not affect taxpayer compliance (**H3 is rejected**).

This study is contrary to the study conducted by Suryadi (2006) [23], suggesting that company size can be assessed from the total value of assets, where large taxpayers having higher level of tax awareness than small corporate taxpayers with larger total assets will tend to be

more obedient in fulfilling their tax obligations compared to companies whose the total assets are small. However, this study is supported by the study conducted by Hani and Lubis (2014) [21], suggesting that the size of the company did not affect taxpayer compliance. This indicates that theoretically the greater the size of the company, the more obedient the taxpayer in fulfilling the tax obligations compared to small companies that are not justified because there are still other factors that can affect taxpayer compliance besides the size of the company. The size of a large company also does not necessarily comply with its tax obligations because the larger the company, the more complex the needs, then the costs incurred for operations are even greater. Hence, the tax burden imposed may not be fulfilled because large companies are more concerned with costs for the needs the principal of the company in producing finished goods.

Simultaneous test results shows that financial condition, type, and size of compliance with SMEs taxpayers with decreasing tax rates as moderating variables are influential. Based on the results of testing the variables in Table I get the results of 0.026 which means that it is smaller than 0.05 then **H 4 is accepted**. Where is the financial condition, type, and the compliance of SMEs taxpayers has a simultaneous effect on SMEs respondents in Bintaro and with the decreasing tax rate as a moderating variable can strengthen the relationship between the dependent independent variables. It can be interpreted that the decrease in the SMEs tax rate can be influenced by the financial condition, type and size of the company which is expected to increase SMEs taxpayer compliance.

Table 1. Test Result

Variable	Std. Error	Beta	t	Sig.
Fin_Con	0.274	0.112	0.882	0.381
Type	0.575	-0.280	-3.235	0.023
Size	1.060	-0.243	-1.748	0.085
Tax_Decre	0.000	0.329	2.281	0.026

Data sources: SPSS, 2019

The findings of the paper are in accordance with the previous study conducted by Nastilova, Puspa, & Yunilma (2014) [24], suggesting that the financial condition of poor taxpayers will have a tendency to ignore tax obligations compared to the taxpayer having good financial condition. Thus, it is expected that with the reduction in tax rates, the SMEs taxpayers can feel lightened in fulfilling their tax burden. There are various kinds of SMEs based on their income in Indonesia. SMEs include taxpayers who are hard to tax (hard to tax). One factor causing hard-to-tax SMEs is that they are large in number so it is not possible to monitor them carefully and intensively and their income is small (Thuronyi, 2003) [25]. Their small income makes the government careful issued this program to reduce the SME tax rate, where it is expected that newer SMEs will emerge and comply with their tax obligations so that state revenues are expected to increase.

## VI. CONCLUSION

Financial conditions do not affect mandatory compliance tax, SMEs in Tangerang with high or low levels of profitability tend to have the same awareness to report taxes. This is contrary to the findings of Nastilova, Puspa, and Yunilma (2014) [24], suggesting that the perceptions of the personal financial condition of taxpayers and tax awareness have a significant effect on taxpayer compliance at KPP Pratama Padang but in accordance with Monica (2013) [13]. The type of business has a negative influence on tax compliance, this can be appear when the greater the company's profits, then the greater the tax liability, consequently the taxpayer tends to try to reduce the tax costs, so that it can be said that tax compliance decreases (rarely measures the type of company according to SME criteria according to PP No. 20 of 2008). Company size does not affect mandatory compliance tax, when company grows bigger, then the need will be increasingly complex, consequently the costs incurred in operations even greater, so that the tax burden imposed may be not fulfilled because big companies are more important costs for the company's operational needs. This finding is contrary to Dewinta and Setiawan (2016) [26], stating that company size has a positive effect on tax avoidance. Financial conditions, types, and measurements have a simultaneous effect on the compliance of SME taxpayers and by decreasing tax rates as moderating variables. The SME's tax tariff reduction was able to encourage tax compliance of SMEs in the Bintaro Tangerang area, but has not been responded massively by the SMEs company. It is hoped that socialization and debriefing can be carried out by the Tangerang municipal government more aggressively and intensively to the SMEs so as to encourage a taxpayer compliance.

This study can contribute both academically and practically as a reference literature for further study similar to this study and as an important information that there is a connection between things used as variables in this study. However, this study also has limitations, firstly respondents are still answers to inconsistent, questionnaires that are according to observations of the researchers, this is because respondents who are less careful reading and understanding questions. So the suggestion of further study is to ensure that the respondents understand the tax question well by verifying the questions that were submitted or completed with the in-depth interview. Secondly, The sample used is relatively limited because there are many respondents who are not willing to fill out the questionnaire, they concerns that occurred between respondents with data filled in the form of taxation. Furthermore, this study needs to be continued by randomly selecting questionnaires for respondents who have been recorded by the SME's ministry and on a wider scale, such as covering 5 big cities or even from all provinces in Indonesia or compare to other developing country such as Malaysia, Philipina and Vietnam.

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