Factors Affecting Perception of Tax Evasion Among Chindos

Arja Sadjiarto[1*], Agatha Nathania Susanto[1], Evania Yuniar[1], Melissa Gunawan Hartanto[1]

[1] *Tax Accounting Department Petra Christian University Surabaya, Indonesia*
[*]*Corresponding author. Email: arja@petra.ac.id*

ABSTRACT

Tax evasion remains an important issue across the globe. There are numerous factors of tax evasion. In a multi-cultural and growing country such as Indonesia, ethnic background of a taxpayer could play a role as a determinant. This paper analyses the factors affecting perception of tax evasion among Chinese Indonesians using Structural Equation Modelling. We divide the determinants into four groups; character and culture, traditional factors, institutional factors, and tax morale. The paper further examines tax knowledge, a moderating variable to see its effect and significance on tax evasion. Character and culture has a significantly positive influence, while institutional factors and tax morale have a highly significant and positive effect towards the perception of tax evasion. Traditional factors shows the opposite. Tax knowledge does not moderate the relationship between character and culture, traditional factors, institutional factors, and tax morale. This study uses a questionnaire survey distributed to individual taxpayers from Surabaya, Jakarta and Medan.

Keywords: perception of tax evasion, tax knowledge, tax morale, character and culture, Chinese Indonesians

1. INTRODUCTION

Tax evasion is defined as any action taxpayers do to hide all or part of their economic activities from tax authorities to avoid paying taxes [24]. Tax has a significant role in the continuity and sustainability of a country due to it being the country's main source of income. Tax evasion holds back the country's income systemically, causing a gap between actual and potential tax revenue [2]. Only Rp. 1,339.8 trillion was realized from a tax revenue target of Rp. 1,450.9 trillion during 2017 [17]. In 2018, only Rp. 1,437.1 trillion was realized from a potential of Rp. 1,577.5 trillion [38]. The difference between actual and potential income could be caused by economic activities that are not detected by the government in Indonesia. One common practice in this context is the phenomenon of tax evasion, an action that is closely related to shadow economy [41]. According to Sucipto, there is an approximate of Rp. 110 Trillion of tax avoidance each year and 20 percent of it alone comes from individual taxpayers [14].

The global phenomenon of tax evasion causes various countries to examine factors affecting tax evasion. Ref. [12] examines tax rate and tax penalties in Yemen. Ref. [39] examines tax morale in Asian countries. As for research conducted in Indonesia, these factors are examined separately and no research has used tax education (tax knowledge) as a moderating variable. Ref. [29] and [22] examined how tax knowledge, tax penalties, and tax rates affect tax evasion. Ref. [27] and [29] consistently explained that extensive tax knowledge would give taxpayers the perception that acts of tax evasion is unethical so that taxpayers would avoid such behaviour.

Hence, this paper aims to analyse the effects of character and culture, traditional factors, institutional factors, and tax morale accompanied by tax knowledge as a moderating variable on the perception of taxpayers to carry out tax evasion. This paper builds on the work of [24].

The diversity of cultures and ethnicities in Indonesia encourages the researchers to consider how important cultural and ethnic factors are to tax evasion because the uniqueness of each culture and ethnicity has revealed various behaviors [7]. A research conducted in Malaysia indicated cultural factors, especially ethnic diversity, as an important factor of tax evasion [19]. Ref. [6] suggested that cultural context must be considered in order to improve taxpayer's compliance. Consequently, this paper is expected to provide an explanation on the influence of Chinese Indonesians (Chindos) character and culture on perception of tax evasion.

This paper hopefully could contribute to tax authorities and the society. It serves as a consideration for tax authorities to produce an effective tax administration by creating a more effective purpose, design and application of Indonesia's tax system. The society, especially taxpayers, is expected to understand the impact of tax evasion to the country and increase their comprehension on taxation thus act objectively and critically when completing their tax obligations.

2. LITERATURE REVIEW

Traditional Factors

Traditional factors are made up of tax rate, tax penalty and audit probability. Ref. [4] shows that tax rate, tax penalty, and audit probability has a positive effect on tax evasion. This is consistent with the findings of [1], [3], [12], [34]. A research done by [12] proved that tax penalty has a negative relationship with tax evasion. According to [25], audit probability has a significant effect towards tax evasion. Ref. [21] deduced that audit probability, measured by previous audits or threat-of-audit let-

ters, have significant negative effect on self-reported income. Based on these previous literatures, hypothesis 1 is developed:

H1: traditional factors affect the perception of tax evasion.

Institutional Factors

Institutional factors has a positive relationship with tax evasion [24]. This is also supported by [26] and [10]. Institutional factors consist of two indicators, i.e. individual taxpayers' perceptions on the society's tax compliance and on the country's level of corruption. Knowing the characteristics that shape someone is important because they are what creates individual taxpayers' morals to have tax compliance behavior. Previous studies have shown that there is an individual, referred to as "an honest taxpayer", who does not try to avoid tax [15], [40]. The relationship between the society's perceptions of level of corruption is supported by several empirical findings. As indicated by [29], [31] and [32], corruption has a positive relationship towards tax evasion. Based on the previous research above, hypothesis 2 is developed:

H2: institutional factors affect the perception of tax evasion.

Character and Culture Factors

Character and culture have three indicators, i.e. religiosity, culture, and work ethic. Ref. [23] found that religious commitment has a positive effect on voluntary tax compliance in Malaysia. A study [33] did in Malaysia found that Christian Protestants are very opposed on tax evasion [18].

As stated by [19], Chinese Malaysians are more compliant towards tax law compared to local Malaysians, despite the difference in this compliance behavior being insignificant. Ref. [9] said that ethnic background may have an impact on taxpayers' morals because Australian respondents view tax evasion as a game compared to respondents with other nationalities.

According to [30], the key to success for Chindos entrepreneurs are the characteristics and traits that they have such as the volition to work hard, the habit of being frugal, the ability to survive during hard times and being diligent as well as disciplined. The majority of companies owned by Chindos are managed by family and extended family members, relatives, or family friends in all management positions [13]. Hence, it is not a surprise that they try to preserve their companies' existence from generation to generation [13]. Based on this explanation, the following hypothesis is developed:

H3: character and culture affect the perception of tax evasion.

Tax Morale

Ref. [35] and [37] were the first ones to introduce the concept of tax morale. In the 1990s, tax morale gained more attention from researchers and became a central issue on empirical studies about tax compliance [39]. Tax morale is an intrinsic motivation of a taxpayer to pay tax that explains the high level of tax compliance. Tax morale helps justify the reason individual taxpayers are willing to comply with tax law despite them seeing tax as an expense that must be paid. If taxpayers do tax evasion then they would receive tax benefits by increasing their economical utilities [5]. Ref. [42] found that personal tax ethics has a causal effect on tax compliance. This finding is supported by [16], an individual taxpayers' compliance is not only shaped by economic utilities consideration, the perception of risk detection by the tax authorities, sanctions and penalties that follow, but

also by their personal norms. From the explanation above, the following hypothesis is developed:

Figure 1. Research Model

H4: Tax morale affects the perception of tax evasion.

Tax Knowledge

Empirical results show that tax knowledge is a necessary thing when the goal of increasing tax revenue is considered [8] and [11]. The aforementioned researches expect tax knowledge to enable taxpayers to understand tax law and procedure while also increasing positive tax compliance behavior. As for research on tax evasion and tax avoidance in Malaysia stated that tax knowledge has a relationship with taxpayers' behaviors on morality and perception of morality related to tax evasion [28]. Ref. [28] believes that increasing taxpayers' knowledge could help increase their awareness on Malaysia's tax system and regulations. Ref. [20] mentioned that the higher the comprehension of taxation is, the fairer tax evasion will be perceived. Therefore, tax knowledge has a moderating role in tax evasion in that it could increase a high spirit of tax compliance amongst taxpayers and could change taxpayers' perception on tax rate, tax penalties and tax audit. The following hypothesis is developed:

H5: Tax knowledge moderates the relationship between character and culture, traditional factors, institutional factors, tax morale, and the perception of tax evasion.

For the purpose of this research, the model in Fig. 1 was made from the previous literature review above as well as the work of [24].
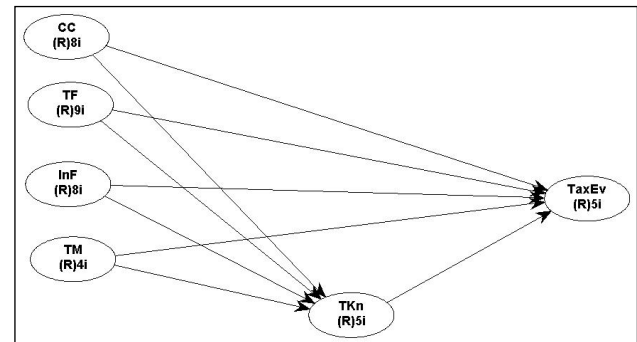
3. RESEARCH METHODS

Sampling and Data Collection Method

This research uses questionnaire survey as the research instrument. The respondents are 173 personal taxpayers living in the three biggest cities of Indonesia i.e. Surabaya, Jakarta, and Medan. The questionnaires were distributed both manually and through online means. Questions were developed based on previous research using a 5-point Likert scale (1 = "Strongly Disagree", 5 = "Strongly Agree").

Measurement of variable

This research uses SEM model with WarpPLS software to examine the factors affecting the perception of tax evasion among Chinese Indonesians. To measure all the latent variables in this research, a 5-point Likert scale questionnaire is applied as the main research instrument.

Perception of Tax Evasion (TaxEv)

The measurement of the perception of tax evasion is a modified scale of [24] in order to match the purpose of this research. The scale consists of five items made up of individual taxpayers and their perception on the probability to do tax evasion. The composite reliability (CR) for TaxEv is 0.937 with 0.916 for Cronbach's alpha (α).

Tax Knowledge (TKn)

This research adopts and modifies the research model of [24] in order to develop a valid scale for measuring taxpayers' perception on tax knowledge. Tax knowledge is measured by five items to measure the level of interest a taxpayer has in understanding taxation. It is considered a moderating variable expected to exhibit the progress of taxpayers avoiding tax because they are not educated on tax issues. CR coefficient for the total scale is 0.808 with α coefficient being 0.703.

Traditional factors (TF)

The scale for traditional factors' indicators, namely tax rate, tax penalty, and audit probability, are made up of nine items that justify the practice of tax evasion. This scale asks the respondents to assess certain actions they would choose to evade tax should they have they chance. CR shows that TF has a coefficient of 0.858 and it has an α of 0.813.

Institutional factors (InF)

Tax compliance as one of the indicators of institutional factors consist of four items where individual taxpayers are asked on their perception of whether or not the society is tax compliant. Likewise, there are four items to measure the second indicator of InF, i.e. individual taxpayers' perception on the country's level of corruption. The CR coefficient for the total scale is 0.839 and the α coefficient is 0.781.

Character and culture (CC)

Character and culture is measured by eight items in the questionnaire. Four items are made to measure Chindos work ethic, two items are in regard to Chindos culture, and another two are in regard to religiosity. The total scale has a CR coefficient of 0.754 and α coefficient of 0.635.

Tax Morale (TM)

Tax morale is an individual's willingness to pay tax, as a result tax morale depends on taxpayer's behavior to obey the rules and social stigma. The CR coefficient for the total scale is 0.824 with an α coefficient of 0.714.

4. RESEARCH RESULTS AND DISCUSSION

Demographic Profile of Respondents

The majority of the respondents live in Surabaya (62.5%), followed by Jakarta (22.5%) and finally Medan (15%). From the total sample of respondents, 59.5% (119 people) are males, and the rest are females. Out of 173 respondents, 55% of them are married and the remaining are single. A large number of respondents are a part of the 20 – 35 years age group (51%). The majority of the group have attained their bachelor's degree (66.5%), 48 (24%) of them have finished high school (24%), and 17 (8.5%) of them have attained their master's degree, doctor-

ate's degree, or certificate of qualification. Overall, most of the respondents received around >Rp. 72.000.000 – Rp.250.000.000 (36.5%) of annual income, followed by >Rp.250.000.000 (22.5%), >Rp.54.000.000-Rp.72.000.000 (16.5%) and ≤Rp.54.000.000 (24.5%).

Model Fitness Test

This research mainly uses average path coefficient (APC), average R-squared (ARS), average adjusted R-squared (AARS), average block VIF (AVIF), and average full collinearity VIF (AFVIF).

TABLE I.   TABLE OF MODEL FIT AND QUALITY INDICES

No.	Model fit and quality indices	Fit criteria	Analysis Result
1	Average path coefficient (APC)[a]	$p<0.05$	0.164 (p=0.005)
2	Average R-squared (ARS)	$p<0.05$	0.231 (p<0.001)
3	Average adjusted R-squared (AARS)	$p<0.05$	0.213 (p<0.001)
4	Average block VIF (AVIF)	Acceptable if ≤5, ideally ≤3.3	1.263
5	Average full collinearity VIF (AFVIF)	Acceptable if ≤5, ideally ≤3.3	1.367
6	Tenenhaus GoF (GoF)	Small ≥0.1, medium ≥0.25, large ≥0.36	0.331
7	Sympson's paradox ratio (SPR)	Acceptable if ≥0.7, ideally = 1	0.778
8	R-squared contribution ratio (RSCR)	Acceptable if ≥0.9, ideally = 1	0.966
9	Statistical suppression ratio (SSR)	Acceptable if ≥0.7	1.000
10	Nonlinear bivariate causality direction ratio (NLBCDR)	Acceptable if ≥0.7	0.778

The analysis results show that APC is considered fit because the p-value is 0.005. Both the ARS and AARS also confirm that this model is fit. Consistently, the value of AVIF and AFVIF confirms that this model is ideal. Based on the results of the value of Tenenhaus GoF (GoF), Sympson's paradox ratio (SPR),

and R-squared contribution ratio (RSCR), the research model used is considered ideal. The SSR and NLBCDR both presented values above 0.7 which suggests that the model is fit [36].

Validity and Reliability Test

The validity test consist of convergent and discriminant validity. Convergent validity is considered fulfilled when one variable, consisting many items, can be measured by its factor loading value. If the factor loading value is >0.3 then it is considered valid. Discriminant validity is determined by comparing the factor loading and cross loading values. If the factor loading value is larger than the cross loading value then the discriminant validity is considered valid. The reliability test is done by using CR and α. For the purpose of this research, CR is fulfilled if the coefficient is ≥ 0.70. Due to the number of items for each variable in the questionnaire, α is fulfilled if the coefficient for is ≥ 0.60 [36]. In Table II, all the factor loadings range from 0.305 to 0.894, exceeding the suggested level (≥ 0.3) which indicates acceptable item convergence on the variables.

Discriminant validity is used to see all the indicators together as a whole by comparing the value of square root of average variance extracted (AVE) from one latent variable to another. If the square root of AVE is larger than the correlation of the variable in question, then the discriminant validity is fulfilled. CC has a square root AVE of 0.536, while the square root AVE of the variable correlations are 0.113 for TaxEv, 0.251 for TKn, 0.228 for TF, 0.308 for InF, and 0.064 for TM showing that all eight CC items meet the discriminant validity. TaxEv has a square root AVE of 0.866, its square root AVE for the correlating variables are 0.113 for CC, 0.053 for TKn, 0.241 for TF, -0.092 for InF, and 0.465 for TM, so all five items of TaxEv meet the discriminant validity. The square root of AVE for Tkn is 0.680, TF is 0.636, InF is 0.630, and TM 0.736, whereas all their correlations are lower. Overall, the AVE values for all

TABLE II. CONVERGENT VALIDITY TEST

Variables	Indicators	Factor Loading	CR	α
Tax evasion (TaxEv)	TaxEv1 TaxEv2 TaxEv3 TaxEv4 TaxEv5	0.859 0.887 0.894 0.847 0.842	0.937	0.916
Tax knowledge (TKn)	TKn1 TKn2 TKn3 TKn4 TKn5	0.778 0.765 0.605 0.520 0.698	0.808	0.703
Traditional factors (TF)	TF1 TF2 TF3 TF4 TF5 TF6 TF7 TF8 TF9	0.559 0.529 0.644 0.767 0.603 0.704 0.661 0.577 0.646	0.858	0.813
Institutional factors (InF)	InF1 InF2 InF3 InF4 InF5 InF6 InF7 InF8	0.604 0.641 0.660 0.677 0.704 0.621 0.526 0.590	0.839	0.781
Character and culture (CC)	CC1 CC2 CC3 CC4 CC5 CC6 CC7 CC8	0.695 0.624 0.636 0.518 0.305 0.397 0.447 0.553	0.754	0.635
Tax morale (TM)	TM1 TM2 TM3 TM4	0.696 0.787 0.651 0.798	0.824	0.714

factors exceeded the acceptable level (0.5). To sum up, all items of each variable meet the discriminant validity.

The CR coefficient for all factors passed the acceptable level of 0.7, i.e. the composite reliability coefficient for TaxEv is 0.937, TKn 0.808, TF 0.858, InF 0.839, CC 0.754, and TM 0.824. α is used to test the questionnaire's reliability and internal consistency. A questionnaire is said to be reliable if the value of α is higher than 0.6 [36]. Based on the convergent validity test as seen in Table II, all the values of α are above 0.6, indicating that the questionnaire is reliable and internally consistent.

Hypothesis Testing

H1 predicts that traditional factors are negatively related to perception of tax evasion. Similarly, H2 predicts that there is a negative relationship between institutional factors and perception of tax evasion; whereas H3 predicts a significant positive rela-

tionship between character and culture and perception of tax evasion.

From Table III, the results of the direct effect of traditional factors on perception of tax evasion are negative and insignificant (β=-0.031, p=0.330). Therefore hypothesis 1 is not supported. It is concluded that there is a negative relationship between tax rate, tax penalty, audit probability and the perception of tax evasion. From the average score of indicators, it can be seen that tax penalty and audit probability are not determinants of perception of tax evasion. Chindos view tax penalty as a fitting punishment but this is not the reason they perceive to evade tax. The same perspective applies to audit probability.

TABLE III. HYPOTHESES TESTING

Variable	Path Coefficient	p-value	Explanation
Standardised direct effect			
Character and culture → Tax knowledge	0.123	0.038	Significant
Character and culture → Perception of tax evasion	0.139	0.023	Significant
Tax knowledge → Perception of tax evasion	0.015	0.419	Not significant
Traditional factors → Tax knowledge	0.136	0.025	Significant
Traditional factors → Perception of tax evasion	-0.031	0.330	Not significant
Institutional factors → Tax knowledge	0.374	<0.001	Highly significant
Institutional factors → Perception of tax evasion	-0.164	0.009	Highly significant
Tax morale → Tax knowledge	-0.050	0.240	Not significant
Tax morale → Perception of tax evasion	0.441	<0.001	Highly significant
Standardised indirect effect			
Character and culture → Perception of tax evasion	0.002	0.486	Not moderating
Traditional factors → Perception of tax evasion	0.002	0.484	Not moderating
tax evasion			ing
Institutional factors → Perception of tax evasion	0.005	0.457	Not moderating
Tax morale → Perception of tax evasion	-0.001	0.494	Not moderating
Standardised total effect			
Character and culture → Tax knowledge	0.123	0.038	Significant
Character and culture → Perception of tax evasion	0.141	0.021	Significant
Tax knowledge → Perception of tax evasion	0.015	0.419	Not significant
Traditional factors → Tax knowledge	0.136	0.025	Significant
Traditional factors → Perception of tax evasion	-0.029	0.340	Not significant
Institutional factors → Tax knowledge	0.374	<0.001	Highly significant
Institutional factors → Perception of tax evasion	-0.159	0.011	Highly significant
Tax morale → Tax knowledge	-0.050	0.24	Not significant
Tax morale → Perception of tax evasion	0.441	<0.001	Highly significant

On the contrary, many Chindos perceive the amount of tax paid to be at least the same or slightly increased, regardless of the increase in tax rate and of their revenue and expense during a certain fiscal year.

Hypothesis 2 shows the direct effect of institutional factors towards perception of tax evasion. The results show that there is a negative and significant effect on perception of tax evasion (β=-0.164, p=0.009) so H2 is accepted. When the average score of indicators are looked into further, it is found that tax compliance has an average score of 3.65. This shows that being compliant is important to Chindos and they perceive the society to be compliant too. On the other hand, the average score of 1.75 for level of corruption suggests that Chindos perceive there is a high level of corruption in Indonesia.

Character and culture factors show a positive relationship with perception of tax evasion, the relationship has a significant effect (β=0.139, p=0.023). The highest average score of character and culture indicators is work ethics with a score of 4.17, which means the respondents value hard work, frugal living and the attitude of not giving up. Religiosity, with an average score of 3.98, indicates that the respondents are the religious ones. Chindos culture follows with an average score of 3.35. Tax is treated more as an expense and hence is to be minimized. Chindos perceive that the people around them do the tax evasion. It could be a possibility that the respondents' religious environment differ from their business environment. To sum up, hypothesis 3 is supported and is accepted.

Tax morale shows a positive relationship with perception of tax evasion (β=0.441). This relationship is highly significant (p<0.001). Therefore, hypothesis 4 is supported and accepted.

Hypothesis 5 is rejected. Despite having a positive relationship between tax knowledge and perception of tax evasion, this relationship is not significant. Moreover, tax knowledge does not moderate the relationship between character and culture factors, traditional factors, institutional factors, tax morale, and perception of tax evasion. This may be due to the fact that tax education has been around in Indonesia for a long time. As a result, Chindos have gained more tax knowledge that allows them to reengineer their self-reported income either by decreasing their taxable income, increasing their deductible expense, or by doing both. Based on the average score of tax knowledge's indicators, it can be concluded that Chindos prefer going to seminars, training, and socialization from Directorate General of Taxes than finding information on taxation through YouTube, tax forum websites, or other social media applications. They also think that tax is a difficult matter to comprehend ergo they choose to consult with tax consultants before reporting their incomes.

6. CONCLUSION

This research contributes toward understanding factors affecting perception of tax evasion for the tax literature. This study develops a more comprehensive model using SEM in order to represent a clearer path on how these variables affect tax evasion. Results show that perception of tax evasion among Chinese Indonesians is only at a moderate level. The significant determinants are character and culture, institutional factors, and tax morale whereas traditional factors does not have a significant effect towards tax evasion.

Traditional factors make Chindos feel the need to widen their tax knowledge. Also institutional factors and character and culture cause Chindos to find out more about taxation. Tax knowledge does not moderate these factors to the perception of tax knowledge.

On the other hand, tax morale is not significant towards tax knowledge, meaning tax morale does not encourage Chindos to learn more about tax knowledge. It only encourages them to understand general tax laws related to their business. Paying tax for their business is their main concern.

Traditional, institutional, and character and culture factors motivate Chindos to gain more knowledge on taxation neverthe-less tax knowledge does not moderate these factors and percep-

tion of tax evasion. In other words, neither an individual's compliance nor noncompliance is affected by their tax knowledge.

An interesting and unique point obtained from this research is that tax morale is of higher significance than character and culture. Business ethics are more important compared to ethnic background for Chindos descents in this generation. Hereinafter, tax evasion is less based on character and culture, but more on tax morale.

This paper cannot be separated from its limitations. This research only includes limited respondents in three cities, i.e. Surabaya, Jakarta, and Medan, hence the results do not represent Chindos across Indonesia. For future research, we suggest expanding the model by using other independent variables such as tax system and tax administration. Future researchers could also broaden it by focusing on other determinants such as business ethics and other ethnic backgrounds and cultures towards perception of tax evasion. From this research, we expect policy makers could increase individual taxpayers' trust in the tax system. Many individual taxpayers who are willing to comply see that if there are a high level of corruption, it may make them in doubt when paying the right amount of tax.

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