

# The Transaction Cost of Tax Compliance on Institutional Change of Tax Regulation : Some Evidence from Indonesia

*by* Prosiding Darwanto

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# The Transaction Cost of Tax Compliance on Institutional Change of Tax Regulation: Some Evidence from Indonesia

Darwanto\*, Pubayu Budi Santosa, and Clara Palupi

*Faculty of Business and Economics, Diponegoro University, Semarang 50275, Indonesia*

Tax regulations change as a part of institutional change in tax system is designed to increase tax compliance of taxpayers. The changing of tax regulation makes some new cost of implementation of new tax system. In further, it would increase transaction cost in tax compliance. The aim of this research was to identify the transaction cost of the changing of tax system in Indonesia. This study will explore qualitatively psychological cost that must be paid by tax payers on the new tax system. The research result will be important in evaluation of implementation new regulation in Indonesia and integrate psychological cost in institutional change.

**Keywords:** Institutional Change, Transaction Cost, Psychological Cost.

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## 1. INTRODUCTION

The realization of the tax revenue is one of the largest of the state revenue which was in between 67% to 85% of the total state revenue from 2007 to 2016.<sup>1</sup> The government continues trying to make the tax revenue continues to increase; one of the efforts that have been made is with the institutional changes referred to tax reform. The first reform was done by changing the tax collection system from the Official Assessment System (OAS) into a Self Assessment System (SAS). Furthermore, the tax reform volume I was done by building a modern tax system, one of which was formed a new section at the tax office, namely Account Representative (AR). This paper discussed how institutional change in the form of AR responsible for providing technical guidance and consulting services tax to the taxpayer which can reduce the transaction cost of taxation or tax compliance cost such as psychological cost.

## 2. LITERATURE REVIEW

### 2.1. Theory of Transaction Cost

Transaction cost arises in the approach of New Institutional Economics which is an institutional approach that uses the framework of neoclassical economics, but reject the assumption of neoclassical stated that economic activities are perfect information, complete rationality, and absence of transaction cost.<sup>2</sup>

Williamson defines transaction cost as a cost that has to be minimized in order to comply with corporate governance

rules/contract, as it becomes the comparative cost plan, adopt, and monitor ongoing activities relate to respect the governance rule.<sup>3</sup> The tax law is a contract that is made to minimize taxpayer opportunistic behavior such as selfish for not wanting to contribute in paying taxes. Transaction cost arises because on the law, there is two-way relationship between human limitations (taxpayer) and the complexity of the information. Limitation of human rational (bounded rationality) does not make all the complex matters relating to a contract contained in the contract, so that the resulting contract is imperfect. Furthermore, taxpayers have limitations in receiving, processing and translating complex information in the contract.

### 2.2. Tax Compliance Cost

The compliance cost is the cost associated with following the rules of taxation in accordance with the tax laws prevailing in a country.<sup>4</sup> Compliance cost is grouped into two parts, namely, internal cost and external costs. Internal cost consists of time spent by staff or an employee of the company to study the tax laws and complete the form a tax return. Meanwhile, the external cost is the cost incurred in complying with the tax that is used for professional advisors such as tax consultants, and accountants from outside the company/business. In addition to the internal cost and external cost, there is also other cost, the psychological cost (mental and emotional cost) in the form of a sense of discomfort of the taxpayer in keeping taxation.<sup>5</sup> Psychological cost is a cost incurred due to stress and or restlessness, nervousness, anxiety, uncertainty occurred in the implementation process of taxation.<sup>6</sup>

\*Author to whom correspondence should be addressed.

### 2.3. Psychological Cost

The psychological cost is calculated by asking the question of assumptions to key persons, if they are free from the psychological burden faced, how much they will pay more than the amount of tax that must be paid (willingness to pay).<sup>7</sup> In this study the psychological cost was calculated based on key person willingness to pay more than the percentage of the actual tax rate. Then the answers of key persons were quantified by multiplying the amount of tax paid by key persons in the tax year 2015. Supposition questions that were posed to the key persons were as follows:

- (1) If your business can be free of the rules/regulations (laws) that give rise to ambiguity taxes (making it easier for you to understand and avoid mistakes);
- (2) If the tax technical procedures are made easier and simpler;
- (3) If the government legally guarantees that the laws of income tax and PPH will not change until the next 5 years.

## 3. RESEARCH METHOD

The object of this research was the taxpayer of micro and small enterprises listed on KPP Candisari Semarang. Determination of key persons was done by incidental sampling technique. A qualitative approach was used to obtain information that was actually experienced by taxpayer in spending or feeling the cost or burden of tax compliance in the form of psychological cost such as information in the form of opinions or information leading to the amount of psychological cost that they felt. Data was obtained using collection techniques of observation data in-depth interviews. Validity technique was a triangulation method performed by the researchers to compare or view the suitability of the data observations and interviews on key persons.

## 4. RESULTS AND DISCUSSION

Before the existence of institutional change in the form of change in taxation systems that was done by the Directorate General of Taxes, psychological compliance cost was considered nothing because technically the taxpayer did not deal with taxation affairs independently. Psychological compliance cost arose from psychological loss because taxpayers had to take care of all their own tax affairs ranging from counting to report taxes. Researcher asked 32 questions to key persons whether they were burdened psychologically for adhering to tax or not. 23 key persons or 71.9% answered that they were burdened psychologically. Only 9 people or 28.1% of total key persons who answered were not burdened psychologically. Then, the researchers also asked questions reason for what make them psychologically burdened by proposed four options reasons.

Table I shows the majority key persons chose reason of tax affairs were complicated and confused, as the main reason that made them feel burdened psychologically. The reasons had the highest value compared with 3 options for other reasons, namely 3.521739. The reason with the second highest value was tax regulations that often change, the value was 2.26087. Key persons stated that this was the reason the most burdensome because with the change in the law or the norm of the new technical would make them should go back to understand the new rules to be able to calculate outstanding tax due to the new regulations. Another reason was the tax affairs made them had to spend a lot of money

Table I. Reasons that made key person burdened psychologically.

	Quite important (3)	Important (4)	Slightly less important (2)	Less important (1)	No answer (0)	Score average
Tax affair is complex and confusing	7	14	2	0	0	3.521739
Tax affair makes tax payer must spend a lot of money and exhausting	6	1	8	2	6	1.73913
Account representative are not much help	1	0	3	2	17	0.478261
Tax regulations often change	5	7	4	1	6	2.26087

Source: Data processed, 2016.

and it was very tiring for them, this reason obtained a value of 1.73913 and it was the second highest.

The least reason that was chosen by key persons or reason which had the lowest value was the reason that the account representative was not much help. In interviews, the researchers asked whether consultation with the tax officer AR (Account Representative) could reduce the psychological burden that was borne by key persons or not, key persons majority answered that the AR could reduce their psychological burden. Key person currently experienced technical difficulties such as confusion taxation for calculating the outstanding tax, and then key persons consulted on AR. Therefore, the presence of AR can reduce or mitigate the psychological taxpayer compliance costs. Psychological cost was calculated by changing the psychological burden felt by key person be a cost that can be calculated, by asking key persons willingness to pay more (in percentage) of the total paid taxes in order to be free of the psychological burden of taxation affairs. Key person's willingness to pay more is shown in Table II.

The result was the key persons were willing to pay more, an average of 0.7396% of the total taxes they paid in 2015 to be freed or spared from the psychological burden. Small scale business entities were willing to pay larger, ie an average of 0.7813% of the micro-scale enterprises were on average willing to pay 0.6979%. In both types of entities question with the average value of the highest willingness to pay was the question No. 3, which key persons of micro and small businesses were willing to pay each by 0.9063% and 0.7813%. It showed that enterprises were willing to pay higher to avoid the tax laws change. The average value of the second highest that key persons were willing to pay was to question No. 1 was equal to 0.75% and 0.7344%. The

Table II. Average percentage of key person willingness to pay more to avoid psychological burden (percent).

Micro business	Minimum value (%)	Maximum value (%)	Mean (%)
Question 1	0.00	2.00	0.7500
Question 2	0.00	2.00	0.6875
Question 3	0.00	2.00	0.9063
Average total of group 1	0.00	2.50	0.6979
Small business	Minimum value	Maximum value	Mean
Question 1	0.00	2.50	0.7344
Question 2	0.00	2.50	0.6406
Question 3	0.00	2.50	0.7813
Average total of group 2	0.00	2.00	0.7813
Psychological cost average	0.00	2.50	0.7396

Source: Data processed, 2016.

Table III. Average cost of psychological tax year 2015 (rupiah).

	Minimum value	Maximum value	Mean
Micro	00.00	3600000.00	471125.2450
Small	00.00	13943376.00	3241900.0681
Total	00.00	13943376.00	1856512.6566

Source: Data processed, 2016.

smallest average value was to question number 2; taxpayers were willing to pay amounted to 0.6875% on micro- and 0.6406% on small business. It happened because the key person felt although the technical procedures of tax were made easier and simpler they were still burdened psychologically. The percentage value key person's willingness to pay more was then transformed into psychological cost, with the results shown in Table III.

The group of micro enterprise spent psychological cost on average in small quantities that was Rp 471,125.2450 while small business entities spent psychological cost on average much larger, amounting to Rp 3,241,900.0681. The amount of psychological cost that was borne by small business entities indicated that enterprises with more complex tax affairs would bear greater psychological costs as well. Small business enterprise would pay taxes which were more than the micro, from the interviews; the majority of micro enterprises only pay PPH final and PPN, while small businesses were also paying withholding taxes article 21 (employee income tax) monthly, tax article 23 (tax income from capital) and pph article 22 (of income tax relating to imports). Therefore the psychological cost that was borne by small business entities was also greater.

## 5. CONCLUSION

Institutional change in the form of technical and regulatory changes in the tax collection system of official became self

assessment system arose tax compliance costs in the form of psychological costs. Before Self Assessment System was implemented, psychological cost was considered non-existent, because the taxpayers did not work on their own business taxation, the taxpayers did not feel psychological loss such as stress, anxiety and inconvenience for taxation affairs. Taxation affairs were complicated and confusing as well as technical often changes in regulations and taxation that was often fickle. It was the biggest cause of their psychological burden that taxpayers felt. Based on the statement of key persons, the presence of AR could reduce the psychological burden that they felt. In consultation and receive technical guidance, confusion taxpayer regarding the tax was reduced. To be free or protected from the psychological burden due to taxation, key persons were willing to pay more on average amounted to 0.7396% of the total taxes they paid in 2015. Small business concerned bear the greater psychological compliance costs than on micro-enterprises, it was because small firms had more complex tax affairs of the micro enterprises.

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