THE EFFECT OF ETHNICITY ON TAX COMPLIANCE OF SMALL MEDIUM ENTERPRISE IN INDONESIA: TRUST AS INTERVENING VARIABLE

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Abstract

The purpose of this study is to examine the relationship of ethnicity with tax compliance with trust as a moderating variable. Besides, this study also examines other variables that have existed in previous studies, namely tax justice and communication. This study employs survey by distributing questionnaires. This study uses a smart PLS analysis to analyze data. The results of this study indicate that tax justice and communication have significant relation with tax compliance. In contrast, ethnicity does not related to both trust and tax compliance. Besides, the results indicate that trust does not serve as an intervening variable. It implies that the Indonesian government needs to improve the tax justice issue related to SMEs tax and continue to communicate to SMEs taxpayer.

Keywords: Ethnicity, tax justice, communication, tax compliance, SME

1. Introduction

The Indonesian government, to date, carry out its government activities, still requires substantial funds. The government must try to increase the receipt of the funds themselves, which aims to meet the needs of the people. Government expenditures from year to year are increasing, so the government needs substantial funds each year. Taxes still dominate the largest state revenue to date that is used for implementation and development and aims to improve prosperity and welfare of the people. Besides, the government using the potential results of natural wealth.

Tax is a tool for the government to achieve the goal of gaining acceptance, both directly and indirectly, from the community that is used to finance routine expenditures as well as national and economic development of the community. Taxes are people's contributions to the state treasury under the law (which can be forced) by not receiving reciprocal services that can be directly shown, and which are used for public purposes.

This study focuses on compliance of SMEs with Government Regulation on SME tax, namely Government Regulation Number 46/2013. This government regulation was enacted starting in

2013 and raises pros and cons. Many people consider that this government regulation is less favorable for economic growth in Indonesia. The primary regulation in this government regulation is the imposition of income tax rates at a rate of 1 percent of monthly turnover or gross circulation of taxpayers who have gross circulation not exceeding IDR 4.8 billion in one year.

Based on the view of the government, this regulation provides convenience for taxpayers where the amount of tax can be calculated, which is 1% of the total turnover. This regulation makes it easier for taxpayers to easily calculate taxes that must be paid so that taxpayers can easily also pay taxes that must be paid. On the other hand, this government regulation has ruled out the "fairness" side, where the amount of tax is determined in stages according to the profit of the taxpayer.

Research on SMEs has been carried out by some researchers. The results of the study show that small entrepreneurs are essential players in a country's tax system. However, research shows that small businesses are more likely to avoid taxes (Kirchler et al. 2007). Prior studies reveal that some variables has a significant influence on tax compliance, such as age (Nordblom & Žamac,2012), gender (Barber & Odean, 2001; Croson & Gneezy. 2009), education (Kirchler et al. 2007), income (Chung & Trivedi, 2003), tax fairness (Inasius, 2015), tax knowledge (Inasius, 2015; Mukhlis et al. (2015). Setyorini & Susilowati, 2018), political connection (Minh & Ngoc, 2020), procedural fairness (Hartner, et al., .2008; Mukhlis, et al.2015). referral (Inasius, 2015), tax justice (Etzioni, 1986; Fadjar, 2012; Setyorini & Susilowati, 2018), and moral obligations (Bobek, et al.,2013)., tax law enforcement (Say Youde & Seunghoo Lim, 2019), and trust to the authority (Say Youde & Seunghoo Lim, 2019). Most of these previous studies tested in stand-alone models. In fact, some of these variables may influence each other.

This study contributes to the literature in several ways. First, this study examines the effect of ethnicity that has not been widely tested by previous studies, especially in Indonesia. Several studies have proven that ethnicity is considered as one of the determinants of tax compliance (Chan, Troutman & O'Bryan, 2000; Song & Yarbrough, 1978). Furthermore, Kasipillai, & Abdul-Jabbar (2006) show that Chinese and Indians are more compliant to comply with tax laws compared to Malay. Second, this study examines the influence of the intervening variable of trust. Taxpayers will trust the government, and they will be willing and vulnerable to the actions of taxation institutions, while also believing that the rights and interests of taxpayers will not be misused (Hosmer, 1995; Sari & Mangoting, 2014). Third, this study employs a structural equation model to examine interrelation among determinants variable.

2. Hypotheses Development

2.1 Effect of Ethnicity on Tax Compliance with Intervening Variable of Trust

Based on cases in Indonesia, many ethnic-related events, such as the May 1998 tragedy. From this case, it can be concluded that the community is divided into two ethnic groups, namely indigenous and non-indigenous. In Indonesia, various regions have their groupings for each ethnic group. The largest indigenous ethnic group is the Javanese who inhabit the island of Java Meanwhile, the dominant non-indigenous people, especially in business, are ethnic Chinese.

Kasipillai & Abdul-Jabbar (2006) reveal that there are differences in the level of tax compliance in each ethnic group in Malaysia. Similarly, Alabede & Zainal Affrin (2011) reveal that ethnicity has a significant influence on tax compliance in Nigeria. This study examines the effect of indigenous (non-Chinese) and non-indigenous (Chinese) on tax compliance. This study assumes that the higher the level of ethnicity that exists, then each person will be more concerned with his group, which resulted in a lower level of tax compliance and trust in the government.

In this study, trust is used as a variable between ethnicity and compliance, because people who are still concerned with their groups will trust their small group compared to the government. Thus, it can be assumed that public tax compliance will be weak. Based on these assumptions, the hypotheses that can be formulated are as follows:

H1: Ethnicity has a relation with tax compliance.

H2: Ethnicity has a relation with tax compliance through the intervening variable of trust.

2.2 The Influence of Tax Justice Variables on Tax Compliance with Intervening Trust Variables

Tax justice in Indonesia is still not consistent; this is because people still feel the government has not been fair in implementing existing policies. It can be seen that there are still many cases of corruption that have occurred in Indonesia lately, especially cases regarding taxation, resulting in tax compliance in Indonesia still weak.

Justice is seen as a human right in social, economic, and academic organizations. With the existence of secure justice, it can affect each person's behavior (Henridon, 1992). Justice is considered as a fundamental right, as an example of the injustice that can be felt to produce intense personal emotions. Many researchers agree that tax justice is a multidimensional concept (Jackson et al., 1986). As evidence, some researchers (Gerbing, 1988; Christensen et al., 1994; Christensen & Weihrich, 1996) reveal that justice has five dimensions identification of tax justice dimensions, namely: general justice, exchange with tax institutions, attitudes toward taxes from rich people, progressive compared to tax rates, and self-interest. Jack and Milliron (1986) argue that tax justice includes at least two different dimensions. One dimension seems to involve trade equity - benefits received for tax money given. Another dimension seems to involve equity in the burden of taxpayers referring to other individuals (the perception of taxpayers from horizontal and vertical equity of the tax system). Taxpayers who have the same ability to pay must be subject to the same tax obligations, while taxpayers who have different abilities must also be distinguished.

This study divides justice into two types of justice, namely: distributive justice and procedural justice. Distributive justice involves considerations related to the outcome of the exchange of resources (how taxes are paid and spent). Procedural justice is related to perceptions about procedures, namely how the system works and how to deal with the body's working income. Studies have shown that citizens who perceive the distribution of tax burdens and benefits across individuals, groups, and society as a whole as fair show as a result more willing to voluntarily comply with tax laws and regulations Distributive justice perceptions have been shown to affect tax compliance (Wenzel, 2003; Kirchler, 2007; Verboon & Goslinga, 2009; Permatasari &Yenni, 2014). Besides, Kornhauser (2007) states that the best way to promote trust is to promote procedural justice. Based on these arguments, the hypotheses that can be formulated are as

follows:

H3: Tax justice has a relation with tax compliance.

H4: Tax justice has a relation with tax compliance through the intervening variable of trust.

2.3. Effect of Communication Variables on Tax Compliance with Intervening Variable of Trust

Communication is the activity of conveying information through the exchange of thoughts, messages, or information by speech, visual, signal, writing, or behavior. The fact is that communication is one of the most potent tools owned by tax institutions. Taxpayers who see and hear and understand the tax institution's plans for tax revenue are more likely to pay taxes voluntarily. Taxpayers must be informed that the money collected from taxes helps the government to provide various services to citizens. Information about tax audits will also put pressure on taxpayers to comply with the tax system.

Communication plays an essential role in developing trust in an organization. Several studies have shown the central role that communication plays in developing and maintaining trust. Trust and communication have been shown to improve organizational outcomes, such as employee participation and work performance (Ellis & Shockley - Zalabak, 2001; Ruppel & Harrington, 2000).

There are two aspects of information that are often discussed in the literature, namely the quality of information and the quantity of information. The quality of information tends to be operationalized in terms of accuracy, timeliness, completeness, and usability and is easy to understand. Research shows that the quality of information is related to a higher level of trust (Folger & Konovsky, 1989; Konovsky & Cropanzano, 1991; Sapienza & Korsgaard, 1996; Simons, 2002; Whitener et al., 1998). Taxpayers will show a higher level of trust when they believe the information, they receive from a tax institution is accurate, timely, complete, and useful, and easy to understand. Thus, the hypotheses that can be formulated are as follows:

H5: Communication has a positive relation with tax compliance.

H6: Communication has a positive relation with tax compliance with the intervening variable of trust.

Figure 1. Research Model
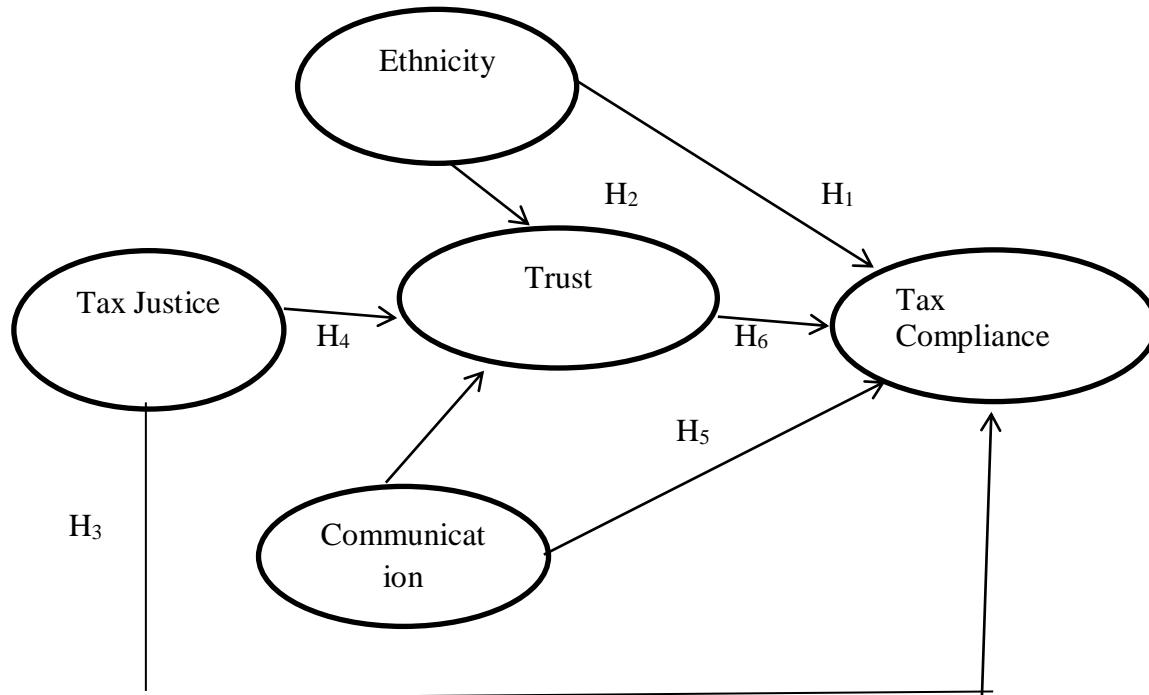
3. Research Method

The type of data used in this study is primary data by distributing questionnaires directly to the intended respondents. The procedure for collecting data is done through the process of distributing questionnaires to individual taxpayers who have a business in Surakarta with a turnover below 4.8 M per year. The population used in this study are all individual taxpayers who have business ventures in Surakarta city, which have a turnover below 4.8 M per year. As the number of the population is unknown, this study used a convenience sampling method. This method produced 80 returned questionnaires.

This study developed questionnaire-based references. The measurements of variables in this study can be summarized in the below table.

Table. 1 Variables Measurement

No	Variable		Indicator
1	Ethnicity		• *Non Chinnese (score=0)* • *Chinnise (score=1)*
2	Tax Justice		• *Taxpayers receive returns that are proportional to paying taxes.* • *Tax of 1% of turnover is according to the ability of the taxpayer.* • *All types of income are subject to the same tax rate, which is 1% of turnover.* • *All turnover that does not exceed IDR 4.8 billion in a tax year must be subject to the same rate, which is 1% of turnover.* • *Government Regulation No. 46/2013 was issued to improve the previous regulations.* • *Government Regulation No. 46/2013 is aimed at the interests of the community (SMEs).*
3	Communication		• *The government provides all information related to Government Regulation No. 46/ 2013.* • *Information relating to Government Regulation No. 46/2013 is useful for decision making for SMEs* • *Information provided by the government regarding Government Regulation No. 46/ 2013 was given on time.* • *All matters regulated in Government Regulation No. 46/ 2013 is easily understood by taxpayers*
4	Trust		• *The government has been able to provide the facilities needed by the community, especially SME players.* • *The government has given attention, empathy, and confidence to the community, especially SME actors by issuing Government Regulation No. 46/2013.* • *The government has carried out integrity in tax rights (honesty, fairness, and trust) by issuing Government Regulation No. 46/2013*
5	Tax Compliance		• *Taxpayers voluntarily calculate and report taxes correctly following Government Regulation No. 46/2013.* • *Taxpayers voluntarily pay taxes on time following Government Regulation No. 46/2013.* • *Taxpayers voluntarily have a willingness to pay taxes following Government Regulation No. 46/2013 without any coercion from institutions.*

4. Results and Discussion

The data analysis was done in several stages. First, demographic respondents included gender, educational level, and age are presented. Second, this presents the inner model (structural

model) and the outer model. The inner model specifies relationships between independent and dependent latent variables, whereas the outer model (measurement model) specifies relationships between latent variables and observed indicators. In the final stage, hypothesis testing was done by using the t-test to examine the significance of the structural path parameter coefficients.

4.1 Profile of Respondent

Descriptions of the profile of respondents include age, education, gender, business age can be seen in Table 2.

Table 2. Profile of Respondents

Profile	Category	Number of Respondents	Percentage
Ethnicity	Indigenous (Malay)	50	50%
	Chinese	50	50%
Gender	Male	78	78%
	Female	22	22%
Age	20 – 30	25	25%
	31 – 40	29	29%
	41 – 50	20	20%
	51 – 60	18	18%
	61 – 70	8	8%
Education	Elementary school	2	2%
	Junior high school	11	11%
	Senior high school	23	23%
	Diploma	5	5%
	Undergraduate	54	54%
	Master	5	5%
		-	-
		-	-
Total		100	100%

4.2 Measurement Model (Outer Model)

4.2.1 Convergent Validity

Convergent validity is the degree to which multiple items are measuring the same concept. As suggested by Hair et al. (2016), factor loadings, and average variance extracted (AVE) are used to assess convergence validity. The recommended value is above 0.5. As shown in Table 3, all variables have AVE values above 0.05.

Table 3. AVE

	AVE
Ethnicity	1.000000
Tax justice	0.527632
Communication	0.636594
Trust	0.736708
Tax compliance	0.838816

4.2.2 Discriminant Validity

The discriminant validity is the degree to which items differentiate among constructs or measure distinct concepts. As can be seen in Table 4, all cross-loadings are higher than the correlating values in the row and the column indicating adequate discriminant validity.

Table 4. *Cross Loading*

	Ethnicity	Tax justice	Communication	Trust	Tax compliance
E	**1,000000**	-0,29379	-0,14721	-0,05324	-0,18266
KDLP_1	-0,326023	**0,76392**	0,48737	0,458034	0,5254
KDLP_2	-0,255031	**0,6772**	0,28133	0,281198	0,169033
KDLP_3	-0,226163	**0,73029**	0,30462	0,137675	0,358211
KDLP_4	0,159087	**0,5804**	0,34602	0,199185	0,214268
KDLP_5	-0,17669	**0,77876**	0,31751	0,196213	0,450727
KDLP_6	-0,295688	**0,80434**	0,29499	0,165502	0,479532
KMK_7	-0,210157	0,38332	**0,8083**	0,452257	0,366103
KMK_8	-0,207658	0,30269	**0,63957**	0,334525	0,507335
KMK_9	-0,047933	0,27063	**0,78728**	0,615026	0,278591
KMK_10	-0,066324	0,5258	**0,87946**	0,632422	0,579204
KMK_11	-0,094475	0,38956	**0,85283**	0,556398	0,34258
KPY_12	-0,056401	0,26584	0,59917	**0,806703**	0,256198
KPY_13	-0,03115	0,31316	0,57818	**0,866219**	0,296391
KPY_14	-0,049578	0,32775	0,52437	**0,899455**	0,365509
KPJK_15	-0,137649	0,49073	0,50699	0,312147	**0,946449**
KPJK_16	-0,125235	0,40784	0,42844	0,266734	**0,876956**
KPJK_17	-0,227097	0,58536	0,5083	0,387258	**0,92284**

Notes: E: ethnicity; KPJK: tax compliance; KMK: communication; KPY: trust; KDLP: justice

4.2.3 Reliability Test

Reliability testing is done by looking at the composite reliability value of the indicator block that measures the construct. The composite reliability results will show a satisfactory value if the value is above 0.7. The following are the values of composite reliability in this study.

Table 5. *Composite Reliability*

	Composite Reliability
Ethnicity	1.000000
Tax justice	0.868942
Communication	0.89651
Trust	0.893361
Tax compliance	0.939748

4.3 Structural Model (Inner Model)

After the estimated model meets the outer model criteria, the following is done by testing the inner model. Following is the R-Square value in the construct.

Table 6. Nilai *R – Square Model*

	R Square
Ethnicity	-
Tax justice	-
Communication	-
Trust	0.442792
Tax compliance	0.392019

The table above explains that trust with a value of 0.442792 means that ethnicity, tax justice, and communication affect trust by 44.28%. Besides, tax compliance with a value of 0.392019 means that ethnicity, tax justice, and communication affect tax compliance by 39.20%

4.4 Hypotheses Testing

Hypothesis testing is to look at the path coefficient table. The results of the hypothesis testing of this study are as follows:

Table 7. *Path Coefficient*

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics (|O/STERR|)
E -> KPJK	-0,020970	-0,019627	0,079795	0,079795	0,262802
E -> KPCY	0,059379	0,064733	0,075006	0,075006	0,791651
KP -> KPJK	0,376193	0,383820	0,091809	0,091809	4,097579
KP -> KPCY	0,062322	0,072603	0,076980	0,076980	0,809584
KPCY->KPJK	-0,009324	-0,019935	0,110783	0,110783	0,084168
KMK -> KPJK	0,350988	0,362304	0,106775	0,106775	3,287184
KMK -> KPCY	0,640635	0,640289	0,076526	0,076526	8,371520

Notes: E: ethnicity; KPJK: tax compliance; KMK: communication; KPY: trust; KP: tax justice

The table above shows that the relationship between ethnicity towards tax compliance has a t-statistic value of 0.262802 (<1.96). This means that hypothesis H1 in this study states that ethnicity affects tax compliance is not supported. Similarly, the relationship between ethnicity and trust is not significant with a T-statistic value of 0.791651 (<1.96). Thus, the hypothesis H2 in this study states that ethnicity has relation with tax compliance through the intervening variable of trust is not supported.

In terms of tax justice, the relationship between tax justice and tax compliance is significant, with a T-statistic value of 4.097579 (>1.96). The original sample estimate value is positive (0.376193), which indicates that the direction of the relationship between tax fairness and tax compliance is positive. Thus, the hypothesis H3 in this study is supported. In contrast, the relationship between tax justice and trust is not significant, with a T-statistic value of 0.809584 (<1.96). Thus, hypothesis H4 that examines trust as mediating variable of the relationship between tax justice and tax compliance is rejected.

The relationship between communication and tax compliance is significant, with a T-statistic value of 3.287184 (>1.96). The original sample estimate value is positive (0.350988), which indicates that the direction of the relationship between communication and tax compliance is positive. Thus, the hypothesis H5 in this study is supported. In contrast, the relationship of trust with tax compliance has a T-statistic 0,084168 (< 1.96), which is not significant. As a result, direct or indirect testing cannot be tested. Thus, the hypothesis H6 in this study is rejected

4.5 Discussion

In this study, out of 6 hypotheses, only 2 hypotheses were proven. The results of this study indicate that the direction of the relationship between tax justice and tax compliance is positive. This result is consistent with previous researches that show the influence of justice on tax compliance (Siahaan, 2012; Azmi & Perumal, 2008; Witono, 2008). It can be concluded that the higher the tax justice carried out by the government; the tax compliance of the SME will increase. Furthermore, the relationship between communication and tax compliance is significant, There are two aspects of information that are often discussed in the literature, namely the quality of information and the quantity of information. The quality of information tends to be operationalized in terms of accuracy, timeliness, and usability. Research shows that the quality of

information is related to a higher level of trust (Folger & Konovsky, 1989; Konovsky & Cropanzano, 1991; Whitener et al., 1998; Sapienza & Korsgaard, 1996; Simons, 2002). The higher the level of communication that exists (between the government and the SME), the compliance might increase as well. Similarly, communication also has a significant relationship with trust. Following prior studies, communication plays a vital role in developing trust in an organization (in this case is SME). Trust and communication have been shown to improve organizational outcomes such as employee participation and work performance (Ellis & Shockley - Zalabak, 2001; Ruppel & Harrington, 2000). Taxpayers will show a higher level of trust when they believe the information, they receive from tax agencies is accurate, timely, and useful, because the amount of information reduces vulnerability.

In terms of ethnicity, the result of this study reveals that ethnicity has no significant relation with tax compliance. It seems that the public in seeing this taxation does not discriminate, or no difference between indigenous and non-indigenous. The results of this study may also be caused by the majority of respondents who are young (15 -40 years old). They no longer think primordial with more concern for their ethnicity or group. The results of this study may also be caused by the majority of respondents who are still young. They no longer think primordial, that is, they no longer pay too much attention to tribes or groups like the older generation. However, they are more open-minded because of the times and the education they have received.

This study cannot prove the role of trust as a moderating variable. Trust does not have a significant effect on tax compliance. From the antecedent side, ethnicity has no significant effect on trust It means that ethnicity does not affect trust, meaning that the SME in Surakarta has similarities in terms of trust in the government. Similarly, tax justice also has no significant effect on trust. It seems that SMEs in Surakarta still feels injustice in terms of tax regulations made by the government. Only communication has a significant effect on trust. This may indicate that the level of taxpayer trust in the government is still low. Slemrod (1998) states that it is the behavior of governments that influences levels of trust. Therefore, the high level of corruption in Indonesia leads to a low level of trust.

5. Conclusion

The purpose of this study was to examine the effect of ethnicity, tax justice, communication on tax compliance of SMEs. The results of the analysis show that communication and tax justice affect tax compliance. This implies that to improve the tax compliance of SMEs, the Indonesian government must focus on these two things. The calculation of the SMEs tax which has been debated should be corrected so that it creates a sense of fairness for the SMEs taxpayer. Also, the government needs to continuously socialize taxes among SMEs with various media. This is expected to increase trust and ultimately improve tax payment compliance.

This study could not provide evidence of trust as an intervening variable. It might because there are still more cases of corruption, as well as government regulations that do not support the people so that public trust in the government is still low.

This study has some limitations. First, the research is only conducted in one area (Surakarta city), so it is necessary to be careful in generalizing the results of the research because each region has distinctive characteristics. Further research, it can add the number of ethnic groups in Indonesia,

because Indonesia itself is a multicultural country that has a diversity of ethnic types. Second, this research examines the tax compliance with tax for SMEs based on Government Regulation No, 46/2013. The Indonesian government already issued new Government Regulation No. 23/2018 that reduces the tax rate from 1 percent to 0.5 percent from turnover. Further study might examine whether the lower tax rate of SME, based on Government Regulation No.23/2018, increases tax compliance.

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