Investigating Tax Compliance Risks of Large Businesses in Indonesia

A thesis submitted in fulfilment of the requirements for the degree of Doctor of Philosophy

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Declaration

I certify that except where due acknowledgement has been made, the work is that of the author alone; the work has not been submitted previously, in whole or in part, to qualify for any other academic award; the content of the thesis is the result of work which has been carried out since the official commencement date of the approved research program; any editorial work, paid or unpaid, carried out by a third party is acknowledged; and, ethics procedures and guidelines have been followed.

Mochammad Hadi Pratomo

02/03/2018
Abstract

The tax compliance behaviour of large businesses is one of the crucial challenges to nation-building in a developing country. However, studies in this area and knowledge of how the respective tax authorities manage the issue are somewhat limited. Hence, this study addresses a gap identified in the body of knowledge and answers research questions pertaining to the factors that influence large business compliance, how they affect it, and how the relevant authority manages compliance risks.

Employing four fundamental research concepts to determine research design, this qualitative study used semi-structured, in-depth interviews to collect data. A total of 48 key informants participated in this study. They were grouped according to their specific tax functions: tax officials, tax managers and tax advisors. The collected interview data was encoded and analysed using thematic analysis. Subsequently, data triangulation, member checking, and disconfirming evidence techniques were used to check the validity and reliability.

Four main findings were derived from the study. First, it was found that four major factors simultaneously affect large business tax compliance in Indonesia. These are: (i) economic (cost-benefit driven decisions, compensation of manager, probability of detection and penalty, risk appetite and uncertainty), (ii) socio-psychological (personal and social norms, fairness and trust), (iii) corporate characteristics (tax risk management, ownership structure and business size, business profitability and the use of tax advisors) and (iv) regulation (complexity, ambiguity, unfairness and regulatory overlap). Secondly, in principle, the Indonesian tax authority (DGT) manages non-compliance by means of two sequential steps: persuasion and enforcement. Thirdly, it was found that the issues of inadequate human resources, poor data management and lack of coordination have impeded the DGT’s capacity to respond effectively to compliance risks. Finally, the introduction of the responsive regulatory approach might have benefits for both the tax authority and taxpayers.

Keywords: tax compliance behaviour, large businesses, influencing factors, managing tax risks, developing country, Indonesia.
DEDICATIONS

This thesis is dedicated to:

my wife Niken Evi Suryani
my son Rafi Aulia Fatoni
... for helping me to reach the end of this PhD journey
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Every journey must come to an end, and this doctoral journey has positively changed me some.

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<th>Description</th>
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<tbody>
<tr>
<td>AEOI</td>
<td>Automatic Exchange of Information</td>
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<tr>
<td>ANOVA</td>
<td>Analysis of variance</td>
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<td>APA</td>
<td>Advance Pricing Agreement</td>
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<tr>
<td>APBN</td>
<td><em>Anggaran Pendapatan dan Belanja Negara</em> (Indonesian State Revenue and Expenditure Budget)</td>
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<tr>
<td>AR</td>
<td>Account Representative</td>
</tr>
<tr>
<td>ATO</td>
<td>Australian Taxation Office</td>
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<tr>
<td>BEPS</td>
<td>Base Erosion Profit Shifting</td>
</tr>
<tr>
<td>BKPM</td>
<td><em>Badan Koordinasi Penanaman Modal</em> (The Indonesian Investment Coordinating Board)</td>
</tr>
<tr>
<td>BOD</td>
<td>Board of Directors</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CFC</td>
<td>Controlled Foreign Corporation</td>
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<tr>
<td>CIT(s)</td>
<td>Corporate income taxpayer(s)</td>
</tr>
<tr>
<td>COSO</td>
<td>Committee of Sponsoring Organization</td>
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<tr>
<td>CoWs</td>
<td>Contract of Works</td>
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<tr>
<td>CRM</td>
<td>Compliance risk management</td>
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<tr>
<td>CSR</td>
<td>Corporation’s social responsibility</td>
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<tr>
<td>DER</td>
<td>Debt-to-Equity Ratio</td>
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<tr>
<td>DGT</td>
<td>Directorate General of Taxes</td>
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<tr>
<td>DPR</td>
<td><em>Dewan Perwakilan Rakyat</em> (House of Representative) Indonesia</td>
</tr>
<tr>
<td>EC</td>
<td>European Commission</td>
</tr>
<tr>
<td>EOI</td>
<td>Exchange of Information</td>
</tr>
<tr>
<td>ESDM</td>
<td><em>Energi dan Sumber Daya Mineral</em> (The Ministry of Energy and Mineral Resources of Republic of Indonesia)</td>
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<tr>
<td>ETR</td>
<td>Effective tax rate</td>
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<tr>
<td>FCC</td>
<td>Foreign Controlled Companies</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>G20</td>
<td>Group of Twenty</td>
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<tr>
<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
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<td>GAAR</td>
<td>General Anti-Avoidance Rule</td>
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</table>
GDP  Gross Domestic Product
GOI  Government of Indonesia
HMRC  Her Majesty's Revenue and Customs
IASB  International Accounting Standards Boards
IDR  Indonesian Rupiah
ICC  Indonesian Controlled Companies
ICIJ  International Consortium of Investigative Journalists
IFRS  International Financial Reporting Standards
IKPI  *Ikatan Konsultan Pajak Indonesia* (Indonesian Tax Consultants Association)
IMF  International Monetary Fund
IRS  Internal Revenue Service
IRSAC  Internal Revenue Service Advisory Council
ITR  International Tax Review
KK  *Kontrak Karya*. See CoW
KPP  *Kantor Pelayanan Pajak* (Tax Office)
LBS  Large Business Service (HRMC)
LMSB  Large and Mid-Size Business (IRS)
LOB  Limitation on Benefit
LTO  Large Taxpayers Office (DGT)
LTRO  Large Taxpayers Regional Office (DGT)
MAP  Mutual Agreement Procedure
MNC  Multinational Corporation
MoF  Ministry of Finance (Indonesia)
MTO  Medium Taxpayers Office (DGT)
NGO  Non-Government Organisation
NPWP  *Nomor Pokok Wajib Pajak* (Tax Identification Number)
OECD  Organisation for Economic Co-operation and Development
OJK  *Otoritas Jasa Keuangan* (Financial Services Authority of Republic of Indonesia)
PBB  *Pajak Bumi dan Bangunan* (Land and Building Tax)
PE  Permanent Establishment
CHAPTER 1
INTRODUCTION

This study aimed to address a knowledge gap that relates to tax compliance behaviour of large businesses. This study sought to obtain a better understanding of the factors that influence tax compliance behaviour of large businesses in Indonesia and how the respective authority is dealing with the associated risks. Despite the abundance of research into corporate taxpayer compliance in recent years, little attention has been paid to the study of large businesses’ tax compliance behaviour in developing countries. The literature is still unclear about the factors that affect this behaviour in a developing country and how the respective tax authorities manages the situation. Hence, this study attempted to contribute to the body of knowledge by addressing the gap concerning large firms’ compliance behaviour.

This study investigated the factors that influence large businesses’ tax compliance from the perspective of tax officials, tax advisors and tax managers, and also explored how the DGT, the Indonesian tax authority, manages the non-compliance issues of large companies.

The research design was constructed on the paradigm of interpretivism as the epistemological framework. As this study was intended to acquire an in-depth understanding of the phenomenon of large business’ tax compliance behaviour based on the participants’ perspectives, an emphasis on the quality of entities, processes and meanings was paramount as the expected information is the knowledge that comes from participants’ rich experiences and their contextual understanding. For these reasons, this study adopted a qualitative approach for the research by employing in-depth, semi-structured interviews to collect data and using thematic analysis as the analytical tools. Previous studies have paid a little attention to large businesses’ tax compliance, especially in developing countries. Hence, this study offers an understanding of the large business compliance behaviour in a developing country, namely Indonesia, and the experiences of the respective tax authority in dealing with the issues, thereby addressing the gap in the literature.
1.1 Background

The importance of tax for a nation is unquestionable. Tax revenue enables a country to provide basic needs, security, welfare and support to its citizens, all of which constitute a legitimate government (McKerchar & Evans, 2009). Hence, the tax authority has a responsibility to promote ongoing economic development, and in the meantime, the stakeholders expect the tax authority to have an effective compliance strategy and deliver an efficient service. Although the tax systems of countries may vary substantially, their tax authorities have a common goal: to collect taxes while simultaneously ensuring the taxpayers’ compliance (OECD, 2004).

Unfortunately, the tax authorities in developing countries face greater challenges compared to their counterparts in developed countries. A limited organisational capacity, a rampant corruption issue, a mounting cash economy problem and an outdated information technology are amongst the main issues that have been recognised as hindering the effectiveness of tax collection (Torgler, 2011). Some studies have identified that there is much room for improvement in the tax administration of developing countries (See for example; Tanzi & Zee, 2000; Baurer, 2005; Brautigram, Fjeldstad, & Moore, 2008; Bird, 2008; McKerchar & Evans, 2009; Gordon & Li, 2009).

Baurer (2005) details several internal shortcomings such as the inability to perform an adequate audits; lack of interest in establishing a self-assessment method; an inefficient voluntary compliance system; lack of specialisation among tax personnel; limited written operational procedures; inadequate training of tax officials; and poor use of information technology including the lack of a centralised system to identify all taxpayers.

Baurer (2005) also indicates other weaknesses, including inadequate internal controls to prevent corruption; poor communication that relies heavily on a top-down management approach, and inadequate efforts to improve the overall image of the tax administration. Regarding services for the taxpayer, limited tax-related education is offered to taxpayers, and the taxpayer may face an uncoordinated audit from multiple sectors of the tax administration office. Moreover, the tax authority has a shortage of staff and staff skills (Baer & Silvani, 1997; Trasberg, 2004; Tanzi & Zee, 2000; Bird, 2008). Also, the tax audit focuses mainly on delinquent tax liabilities which are not
being aggressively enforced because of external intervention such as political interference. Another worrisome characteristic of tax administration in developing countries is their limited focus on large taxpayers despite the higher revenues that potentially could be collected from this group (Gordon & Li, 2009).

In recent years, the issue of large business’ tax compliance behaviour has become a global concern (Braithwaite, 2005). As tax avoidance and evasion are becoming universal problems, the public must be aware that the revenue loss may cause severe damage as it threatens the financing of essential services for society as a whole (Franzoni, 1999; Eisenhauer, 2008). Nowadays, tax authorities are facing greater challenges in collecting taxes as businesses are operating more globally and therefore have more complex structures, for example, tax disputes on high-profile cases that involving well-known corporations such as Google, Apple and Amazon (Tomkins, Packman, Russel & Colville, 2001). It has been estimated that the amount of corporate tax avoidance is about a quarter of the total corporate profits in developed countries and the proportion is more substantial for the developing countries as they are more susceptible to tax avoidance activities (Dharmapala, 2014). According to Gordon and Li (2009), many tax authorities in developing countries depend on corporate income taxes as their main source of revenue estimated to be 19.3 percent on average compared to their counterparts in developed countries at only 9.7 percent.

Indonesia is no exception; the Indonesian tax system has a history of heavy reliance on corporate taxes. The dependence concerns not only the amount paid by the corporate taxpayers but also the significant role played by these taxpayers. For example, Arnold (2012) stated that the natural resources industry is the backbone of Indonesian’s tax as it contributes up to 20 percent of the total corporate tax revenue. Regarding the importance of large businesses’ role in Indonesia, Le Borgne et al., (2008) identified that although there were only about 300 large taxpayers, they accounted for up to 27 percent of the nation’s total revenue and the internal data from the DGT showed that the taxpayers registered with the Large Taxpayers Regional Office (LTRO) contributed around 40 percent to Indonesia’s annual tax revenue (DGT, 2016). Hence, any disruption to tax revenue from the large corporations would result in less government expenditure on infrastructure and public welfare.
As a developing country, Indonesia faces several problems with regard to large businesses’ compliance. Besides the issue of low tax collection productivity compared to its neighbouring countries like Malaysia or Thailand as pointed out by the International Monetary Fund (IMF, 2017), the tax compliance of large businesses poses a greater challenge requiring better management. Rahayu (2014) stated that 70 percent of the foreign direct investment (FDI) companies had not paid their taxes as they were continuously reporting losses or, as stated by the Indonesian Minister of Finance in 2015, around 4,000 foreign companies had not filed an income tax return since their establishment in Indonesia (Gandhi, 2015). Moreover, the Panama Papers case indicated that at least 4,300 Indonesian companies or their affiliations have offshore accounts in tax haven countries (ICIJ, 2017). Meanwhile, the estimated losses of this non-compliance in terms of uncollected tax payable is IDR two trillion each year from only the FDI companies (Lestari, 2008) and the losses caused by the alleged tax evasion by 2,000 foreign firms has been around USD 37.53 billion over the past ten years as reported by the Jakarta Post (2016). Hence, this issue raises questions regarding the actual behaviours of large businesses in Indonesia in terms of taxation, and the factors that motivate taxpayers to comply, both of which were addressed in this study.

Apart from depending on corporate tax revenues, the Indonesian tax administration appears to rely on the command and control approach conducted mainly through tax audits (Arnold, 2012) and penalties to enforce compliance or deter non-compliance (Rizal, 2011). Given the fact that a tax administration has limited resources for conducting extensive tax audits, arguably, an alternative approach to improve compliance is reasonable. Therefore, McKerchar and Evans (2009) suggested that developing countries should call for a synchronised and coordinated plan, accompanied by multiple comprehensive policy instruments and supported by a robust regulation policy in order to improve the compliance record.

Despite the limitations that constrain a developing country, the respective tax administrations ideally should seek and apply the best available approach to meet their objectives of collecting taxes effectively and improving compliance optimally.

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1 See section 2.3 regarding tax compliance issues in Indonesia for more details.
The OECD (2001) suggested that a systematic model incorporating risk management as a tool could be used to enhance taxpayers' compliance. In this vein, Braithwaite and Braithwaite (2000) argued that relying solely on the deterrence approach to improve the overall compliance is inadequate.

Hence, in 2009, the Organisation for Economic Co-operation and Development (OECD) published a practical guide for tax administrations which incorporated compliance risk management (CRM) in the compliance strategy (OECD, 2009). From eight OECD members' experiences, the incorporation of CRM system brought positive results, such as an improvement of corporate governance practices within the organisation. Realising the potential, the Australian Taxation Office (ATO) (2010) released a policy that emphasised the importance of good corporate governance practices, sound tax risk management (TRM) and better relationship with large businesses in order to maintain compliance. The ATO's new approach adopted for large corporations was followed by other tax administrations which suggested that large businesses should have a systematic method in place to ensure that they are complying with the tax laws (Brondolo, 2009).

However, given Indonesia's low tax productivity, taxpayers' chronic non-compliance activities, and the sub-optimal capacity of the tax authority, it would be interesting to discover the actual practices of large businesses in the country and their attitudes toward taxes, tax administration and the government in particular. Moreover, it would be valuable to investigate how the tax administration manages those issues. Observing the shortcomings and exploring the possibility of introducing a better approach to improve taxpayers' compliance are avenues worthy of further investigation.

1.2 Motivation

As a developing economy, Indonesia faces many challenges in its attempts to improve taxpayer compliance. As stated by McKerchar and Evans (2009), a lack of appropriate policy may hamper the effort to improve compliance. In this case, Indonesia was an appropriate context for this study given the researcher’s background and knowledge and his belief that it would be useful to explore the current practices in Indonesia. By bridging the gap between the current practices and the available knowledge, the researcher argues that the findings would be valuable not only for Indonesia but also
for tax administrations in other developing countries in similar situations regarding tax compliance.

Although the majority of countries in the world are developing countries, there are few tax compliance studies in developing countries. Most of the previous studies have focused on developed countries and have tended to concentrate on individual rather than corporate taxation (McKerchar, 2001). Hence, the researcher was motivated to investigate the issue of large businesses’ tax compliance behaviour in Indonesia in order to address the gap in the literature concerning tax research on developing countries.

Another motivation for this research is the fact that corporate compliance behaviour is a relatively new area of research and any findings related to the corporate decision either to comply or to not comply may advance the understanding of the respective issues (Hanlon & Heitzman, 2010). Unlike the individual taxpayer, a corporation as a separate entity has some particular characteristics before the law such as its legal status, its obligation to shareholders and its distinct business profile; hence, in order to acquire a better understanding of corporate behaviour, a different research approach should be taken (Slemrod, 2004; Armstrong et al., 2012; Hanlon & Heitzman, 2010; Lanis & Richardson, 2012). Moreover, the nature of large business with its more sophisticated transactions places additional pressure on the tax authority to anticipate riskier complexities. Braithwaite (2005) argued that a progressive global tax planning strategy and a harmful corporate tax competition among countries made it difficult for authorities to implement a series of appropriate policy strategies. In fact, Ernst and Young (2009) pointed out that although the government has made preparation to tackle the problems, the anticipation itself still causing complexity, uncertainty and controversy. Hence, the interesting nature of a corporation itself aroused the researcher’s curiosity and was another motivation for carrying out this research.

Finally, as a tax official from a developing country who has had the opportunity to conduct further academic research, it is encouraging to have the chance to explore the best available solutions to tackle the problem of non-compliance. Further, the researcher could determine whether the system or the model implemented in a developed country would be appropriate for the Indonesian setting. As previously
stated by Ayres and Braithwaite (1992), the conventional approach that depends on command and control to enhance taxpayers’ compliance as currently applied by the Indonesian tax authority is regarded as inadequate and inefficient. In terms of large business compliance, it is essential to consider the impact of their overall behaviour as well (Lavermicocca & McKerchar, 2013). Moreover, an understanding of large business behaviour would be necessary, and to handle compliance problems, some flexibility that is aligned with the level of the taxpayer’s compliance risks is needed (Braithwaite & Wirth, 2001). In this sense, the researcher realises that corporate tax compliance behaviour is a relatively new area of research and most of the information has been derived from the experiences of developed countries. The researcher is aware that as a high context phenomenon, a single tax research and its findings cannot be a panacea for all tax compliance problems and no single generic approach is appropriate for every country without prior reviews and analysis. Therefore, the researcher believes that this study, conducted in the context of a developing country, contributes to an understanding of the factors that influence large firms’ tax compliance and how the tax authority is managing the situation.

1.3 Research objectives and research questions

The objective of this study was to investigate the factors that influence large business tax compliance in Indonesia and how the tax authority manages this situation. It was anticipated that several parties would influence the compliance of large corporate taxpayers. It was also expected that the decision about whether or not to comply would depend on external factors as well as the internal dynamics of a large business. Hence, it was assumed that it would be significant for the study to include the opinions and perspectives of relevant parties who contribute to large businesses compliance. Accordingly, to gain a better understanding of the abovementioned issues, this study obtained opinions from three inter-related parties: tax officials, tax managers and tax advisors who were representing the tax function in practice as regulator, taxpayer and intermediary as these three groups were regarded as having experiences and knowledge. Therefore, the following actions were established to address the aims of this study:

a. To conduct a review of the relevant literature in order to identify: (i) Definitions of the concepts of tax compliance, tax avoidance and tax risk; (ii)
The determinants and the conceptual understanding regarding factors that are influencing corporate compliance behaviour; (iii) The appropriate frameworks as the basis of analysis in the study, and; (iv) The knowledge gap in the existing literature.

b. To undertake necessary fieldwork as the means of collecting data from the participants after the research design and the methodology of the study had been determined.

c. To analyse and examine the collected data with thematic analysis and corroborate it with point (a) above in order to validate the results of the analysis.

d. To apply the findings to the context of tax administration in Indonesia for its policy implications.

Therefore, to achieve the research objectives, this study was guided by the following research questions:

1. What are the factors that influence large businesses' tax compliance risks from the perspectives of the tax officials, the tax managers, and the independent tax advisors?
2. How does the tax authority manage large business taxpayers' compliance risks according to the factors identified by addressing the previous research question?

In order to answer those research questions satisfactorily, the following goals were established:

i. To acquire insights on large business compliance behaviour and examine any existing non-compliance issues;

ii. To determine the main factors affecting large companies' tax non-compliance and to understand the emerging perspectives on this matter;

iii. To obtain an understanding of the tax compliance process in large businesses and analyse their interaction with their external tax advisors and vice versa;
iv. To gain insights on the relationship between the tax authority and large corporate taxpayers and analyse the effectiveness of this relationship.

v. To evaluate the significance of the non-compliance risks and examine how the DGT counters the risks.

1.4 Significance of the study

This study systematically investigated the factors that influence large businesses’ tax compliance and how the tax authority is managing the issues. The findings of the study will explain the factors that contributed to the tax compliance behaviour of large businesses in Indonesia and the measures taken by the tax authority to tackle large corporate taxpayers’ non-compliance problems. Hence, it is envisaged that this study will make at least three significant contributions.

First, it adds to the literature in the area of tax research, particularly the study of corporate tax compliance in a developing country. Although the tax compliance of large businesses has become a major issue in tax research because of its economic importance, the factors that influence their compliance in a developing country have, unfortunately, attracted little research, since most studies have focused on the experiences of developed countries. Moreover, this study is the first to use the qualitative method to analyse the issue of large businesses tax compliance in Indonesia as most of the previous empirical researches were conducted using a quantitative approach.

Secondly, this study obtained perspectives of large business compliance from three inter-related groups that represent the tax function. In particular it is worth noting that the point of view of tax officials is rarely available in the literature although the officials play an important role in shaping taxpayers’ compliance. The researcher has

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2 For example, previous studies on Indonesian large businesses have discussed tax compliance cost (Susila & Pope, 2012; Pope & Susila, 2014); tax aggressiveness that relates to the changes in corporate income tax rates (Hartadinata & Shauki, 2013); tax avoidance practices by the FDI companies (Rahayu, 2014); transfer pricing issues (Mulyani, 2010). See the details of previous studies in Section 3.7.
found previous relevant studies that incorporate tax officials’ perspectives, although these are rare in qualitative studies.³

Finally, this study enriches the research literature on tax administration by elaborating on the strategy used by the tax authority and the challenges it faces when tackling the issue of large business non-compliance in a developing country. Moreover, regarding practical application, the study contributes to the Indonesian tax policy improvement by making relevant policy recommendations for the competent authority based on the findings of this study.⁴

1.5 Scope of the study

Given the time constraint and the importance of making the study manageable, it was important to specify the scope of this study. First, this study was specifically conducted to investigate the factors that influence large businesses’ compliance and how the tax authority is managing the issues. In the Indonesian context, and for the purposes of this thesis, a large business is defined as a business with an annual turnover in excess of IDR 50 billion or USD 3.85 million⁵. Hence, this study did not include a discussion of other types of taxpayers such as the individual taxpayer or the small business taxpayer.

Secondly, this study was conducted using the qualitative approach whereby the data was collected from semi-structured interviews and from public archival records to support the interview data. Documents such as the Indonesian tax laws and related regulations were used as references. Other sources such as the Indonesian budget statement from 2010 to 2016, the international organisations report from the World Bank, the IMF and the OECD were also examined. Information was also acquired from relevant formal sources such as the DGT’s website. Therefore, the study did not intend

³ For example, these are some studies that incorporated tax official’s point of view: Job & Honaker (2003); Murphy (2004a); Morris, Lonsdale & Revenue (2004); Boll (2011); Mahmood (2012).
⁴ The details of the policy recommendations offered are presented in Section 8.4.
⁵ Article 6 of The Law Number 20 Year 2008 of Micro, Small and Medium Businesses defines the business size by its turnover. As an illustration, Figure 2-5 at page 18 indicates tax revenue contributions collected from large businesses that registered in the Large Taxpayer Offices who manages fewer than 1,000 corporate taxpayers, however, they contribute for over 32 percent of the DGT total tax revenue every year.
to generalise the findings as representations of the participants’ community that had been involved in the study, namely, tax officials, tax managers and tax advisors, but rather sought to gain insights regarding the phenomenon of large business tax compliance behaviour and the tax administration situation in Indonesia.

Thirdly, it needs to be acknowledged that the study has several limitations discussed in more detail in Section 8.5. Finally, although this study intersects with other tax research areas such as tax accounting, transfer pricing, or tax evasion, it should be noted that this thesis is concerned with income tax compliance or non-compliance only and it is important to emphasise that a discussion of those areas is beyond the scope of this study.

1.6 Overview of research design

This study was conducted using a qualitative methodology approach in order to obtain comprehensive and detailed information about large business behaviour and practices in Indonesia. Accordingly, in-depth semi-structured interviews were used to collect data from 48 participants who were categorised into three groups: tax officials, tax managers and tax advisors. To enrich and substantiate the collected data, secondary data was acquired from other relevant sources such as the published and unpublished material from the DGT, reports from the Ministry of Finance (MoF) of Indonesia, reports from the international donors and organisations and the official websites of several institutions in Indonesia. The collected data was then coded and analysed by means of thematic analysis. NVivo software was used to sort, group and compile the data for the purpose of further analysis. The findings obtained were compared with and corroborated by the findings from previous studies to achieve the research objectives and to answer the research questions. Accordingly, the methodology and research method selection and its justification are discussed further in Chapter 4.

1.7 Structure of the Thesis

This thesis consists of eight chapters including this introductory chapter. Chapter 2, Background of the Indonesian Tax Administration, explains the contextual background by giving an overview of the Indonesian tax system and its compliance issues.
Chapter 3, *Literature Review*, reviews the relevant literature, beginning with a discussion of relevant concepts such as tax compliance, tax avoidance and tax risk. The chapter then briefly examines the factors influencing corporate compliance behaviour under three major categories: economic factors, socio-psychological factors and corporate characteristics. This is followed by a discussion of responsive regulation and corporate risk management. The chapter concludes with a review of previous compliance studies in the Indonesian context and identification of the knowledge gap that this study addressed.

Chapter 4, *Research Design and Methodology*, outlines the research design and the adopted methodology. It provides details of the methodology, theory, domain and research method adopted for the study. The chapter also discusses the process of data collection and its analysis. Chapter 4 concludes with a discussion of the reliability and validity of the research instrument and subsequent findings.

Chapter 5, *Factors That Influence Large Business Compliance*, presents the findings related to the first research question of the study. It outlines the corporate factors and the regulation factors as the major findings.

Chapter 6, *The Tax Authority's Responses to Large Business Compliance Risks*, presents the findings pertaining to the second research question. The chapter discusses the DGT's current capacity and how it manages the issue of non-compliance. Chapter 6 concludes with the participants’ opinions regarding responsive regulation.

Chapter 7, *Discussion*, summarises the findings discussed in detail in Chapters 5 and 6 in relation to the existing literature, and discusses their implications. The chapter also revisits the research questions which guided this study.

Finally, Chapter 8, *Conclusions and Policy Recommendations*, concludes this thesis and provides a summary of the study, its contributions, policy recommendations, limitations of the study and suggestions for future research.
CHAPTER 2
THE BACKGROUND OF INDONESIAN TAX ADMINISTRATION

2.1 Introduction

The purpose of this chapter is to explore the research background that underpins this study. It includes a description of the Indonesian tax system in Section 2.2 comprising a discussion of the revenue and tax structure, income tax and corporate income tax, and tax administration. Section 2.3 discusses four indicators of compliance issues in Indonesia that pertain to corporate taxpayers. Section 2.4 concludes the chapter.

2.2 Overview of the Indonesian tax system

Under the Indonesian constitution, there are two main administrators responsible for collecting taxes in Indonesia. The first is the central government which includes the DGT that is responsible for administering the tax system, as well as levying and collecting central government taxes such as income tax and value-added tax (VAT).

The second is the level of government that is responsible for collecting local government taxes such as the vehicle tax and the hotel and restaurant tax. This authority has two levels of administrators: the provincial government and the municipal or city government (Parlaungan, 2017).

Central government taxes are stipulated in the Taxation Laws that are issued jointly by the parliament and the central government. Currently, there are five laws related to the central taxes under the DGT’s administration (Rosid, 2017); these are: The Law of General Provision and Taxation Procedures (Law Number 6 of 1983); The Law of Income Tax (Law Number 7 of 1983); The Law of Value Added Taxes and Luxury Sales

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6 Two agencies administer the central government taxes - the Directorate General of Taxes (DGT) and the Directorate General of Customs and Excise. These two agencies are under the MoF.

7 Local government taxes are stipulated by local regulations which are issued by the respective local government after it has approval from the local parliament for the respective draft of local tax laws. Nevertheless, it is worth noting that the local taxes cannot overlap with the central government taxes and the regulations must be in accordance with the Laws of Local Tax and Retribution.
Tax (Law Number 8 of 1983); The Law of Land and Building Tax (Law Number 12 of 1985); and The Law of Stamp and Duty (Law Number 13 of 1985).

2.2.1 Revenue and tax structure in Indonesia

Indonesia relies heavily on taxes to sustain its finances. The contribution of taxes to the State Revenue and Expenditure Budget (APBN) was about 76 percent on average from 2010 to 2016, and the national budget revenue is derived mostly from domestic taxes rather than from non-tax sources. The dominant role of tax revenue in financing the budget is shown in Table 2-1 below. As Table 2-1 shows, the composition of the state budget was dominated by domestic revenues from 2010 to 2016, with domestic taxes on average contributing around 76 percent to the budget whereas the rest is contributed by non-tax revenues derived from natural resources, profit transfers from state-owned enterprises, public service institutions, and other non-tax sources of revenue.

<table>
<thead>
<tr>
<th>TABLE 2-1 STATE BUDGET REVENUES 2010-2016 (IN BILLIONS USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Composition</td>
</tr>
<tr>
<td>--------------</td>
</tr>
<tr>
<td>1 Tax Revenues</td>
</tr>
<tr>
<td>a. Domestic Tax</td>
</tr>
<tr>
<td>b. International Tax</td>
</tr>
<tr>
<td>2 Non Tax Revenue</td>
</tr>
<tr>
<td>a. Natural Resources</td>
</tr>
<tr>
<td>b. Profit Transfers From State-Owned Enterprise (SOE)</td>
</tr>
<tr>
<td>c. Other Non Tax Revenues</td>
</tr>
<tr>
<td>d. Revenue from Public Service Agency (PSA)</td>
</tr>
<tr>
<td>II. Grants</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Source: Republic of Indonesia (2016; 2017)

It is worth noting that the Laws (Undang-undang) act as the highest order of regulation under the Constitution which is generally established by the parliament (the People’s Representative Council). Meanwhile, the executive or the President can propose a bill to the parliament. Concurrently, at the level of central government, Undang-Undang (the law) is the highest order in the hierarchical system and, based on this order, then the lower ranks of regulation can be derived, for example, the Governmental Regulation, the Presidential Regulation and Regional Regulation (Article 7 of the Law Number 10 of 2004 concerning the Formulation of Laws and Regulation). Meanwhile, the ministerial decrees and the decrees of the Director General of the DGT are two types of regulation that are issued if specific laws such as the tax laws have mandated to do so. See Appendix A for more detail.

The number of the Indonesian budget is converted to US Dollar (USD) from the Indonesian Rupiah (IDR) based on the year end exchange rate that provided by the Indonesian central bank. Data was retrieved from http://www.bps.go.id/LinkTableDinamis/view/id/952
Figure 2-1 below shows the trend of domestic tax increasing steadily from 70 percent contribution in 2010 to 80 percent in 2016. Conversely, the non-tax revenue decreased gradually from 27 percent in 2010 to 17 percent in 2016, with the natural resource revenue having the greatest decline from 17 percent in 2010 to four percent in 2016.

![Figure 2-1 Trend of Revenue in the State Budget 2010-2016](image)

**FIGURE 2-1 TREND OF REVENUE IN THE STATE BUDGET 2010-2016**

Source: Republic of Indonesia (2016; 2017)

In general, domestic taxes are mainly comprised of income tax, VAT, and excise duties. Figure 2-2 shows that in the past seven years from 2010 to 2016, the largest proportion of domestic tax revenue has been collected from income tax, VAT and excise duties with the average share of 50.37 percent, 35.49 percent and 10.65 percent respectively as shown in the pie diagram below.

![Figure 2-2 Proportion of Domestic Taxes (2010-2016)](image)

**FIGURE 2-2 PROPORTION OF DOMESTIC TAXES (2010-2016)**

Source: Republic of Indonesia (2016; 2017)
The DGT administers five central government taxes: Income Tax, VAT, Sales Tax on Luxury Goods, Land and Building Tax for Mining and Estate and stamp duty. From 2010 to 2016, the contribution of income tax increased from IDR 334.8 trillion to IDR 666.2 trillion or almost double the revenue collected in 2010. The contribution of the VAT peaked in 2015 with IDR 423.7 trillion and slightly declined in 2016 to IDR 412.2 trillion as shown by the trend depicted in Figure 2-3.\textsuperscript{10}

![Figure 2-3](image)

\textbf{FIGURE 2-3 TAX COLLECTED BY THE DGT 2010-2016 (IN TRILLIONS IDR)}

Source: Republic of Indonesia (2016; 2017)

Regarding the tax revenue that is generated from corporate taxpayers, the Indonesian tax system has a history of heavy reliance on the corporate taxpayer to generate, withhold and pay the taxes. The system mandates the corporate taxpayer to act as the tax withholder which means that the taxes on employee salaries and wages are withheld by their employer that is most likely to be the corporate taxpayer who transfers the tax money to the Government’s account. The system classifies this tax revenue as ‘tax revenue generated from corporation’ rather than under the classification of ‘tax revenue generated from individual’.\textsuperscript{11} As stated by Francis (2012),

\textsuperscript{10} For information, the exchange rate of USD 1 to IDR from 2010 to 2016 is 8,991, 9,068, 9,670, 12,189, 12,440, 13,795 and 13,436 respectively. (The exchange rate is retrieved from [http://www.bps.go.id/LinkTableDinamis/view/id/952](http://www.bps.go.id/LinkTableDinamis/view/id/952))

\textsuperscript{11} The DGT classifies tax revenue differentiation is not by the tax source but by the actor who pays the tax money into the Government’s account. For example, tax on salary or wages is withheld by their employers- i.e. corporations or government agencies, although, in fact, this type of tax is personal income tax but it is categorised under the classification of ‘income tax revenue generated from corporation’ as the corporation is the actor who pay the respective tax to Government’s account.
there is no direct split-up between personal income tax and corporate income tax in Indonesia. The IMF (2011) confirmed this by stating that the official statistics do not differentiate income tax from individual and corporate taxpayers and later the IMF (2011) estimated that 80 percent of income tax revenue is derived from the corporate taxpayer. Figure 2-4 demonstrates the crucial role of the corporate taxpayer in generating revenue under the Indonesian tax system. Under the DGT’s classification, corporate taxpayers have contributed more than 90 percent of total revenue from 2005 to 2016, while the individual taxpayers and treasurer taxpayers have less than 10 percent of contributions during the respective period.  

**FIGURE 2-4 TAX REVENUE CONTRIBUTIONS PER CATEGORY OF TAXPAYER 2005-2016 (AS PERCENTAGE OF TOTAL REVENUE)**

Source: DGT (2012; 2017)

In the corporate taxpayer category, the group of large taxpayers plays a vital role in generating tax revenue. Susila (2014) argued that despite its small number of registered taxpayers, the group contributed significantly to the total tax revenue. Figure 2-5 below indicates tax revenue contributions collected by the Regional Large Taxpayer Office (LTRO) that manages fewer than 1,000 registered corporate taxpayers compared to the other 30 regional offices in the DGT. This figure shows the contribution of the LTRO compared with the combination of all other regional tax

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12 Under Indonesian tax law, three types of income taxpayers are recognised, namely, corporate taxpayer, individual taxpayer and treasurer taxpayer. A treasurer taxpayer is a government’s official in a government agency that has been appointed and mandated by the law to withhold the relevant tax payable in accordance with government payments to the external parties where the source of the payment is from the State budget.
offices in the DGT. Despite showing a decline in the revenue contribution, the LTRO accounted for over 32 percent of the DGT total tax revenue every year.

![Figure 2-5 The Regional LTO Shares of Contribution 2006-2016](image)

**Figure 2-5** The Regional LTO Shares of Contribution 2006-2016

Source: DGT (2012; 2017)

### 2.2.2 Income tax in Indonesia

Income tax in Indonesia is stipulated by Law Number 7 of 1983 concerning Income Tax. The law itself has been amended four times with amendments in 1991, 1994, 2000 and the latest one was in 2008. The main purpose of these amendments was to improve fairness, to enhance service quality, to promote certainty and to encourage voluntary compliance of taxpayers, as well as to improve professionalism, transparency, law enforcement, and update information technology from the side of tax administration (Rosid, 2017).

Liability to income tax in Indonesia in general, based on residency status; Indonesian residents are taxed on their income derived from worldwide sources, while the non-residents are taxed on income derived from Indonesian sources. Indonesia imposes a range of taxes on corporate and individual taxpayers which includes: (1) corporate income tax; (2) individual income tax; (3) withholding tax on employees’ remuneration, and various payments to third parties.

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13 As stipulated on Article 4 (1) of Law Number 7 of 1983 concerning Income Tax.
A self-assessment system was introduced to the income tax system in 1983 (Gillis, 1985). This system requires the taxpayers to self-calculate and self-report their tax obligations on a regular basis. Along with self-assessment, the income tax system in Indonesia also includes the withholding taxes whereby the government obliges particular taxpayers to withhold or deduct a certain amount of taxes from other taxpayer payments and then remit the said taxes to the government (Mulyani, 2010). Indonesia has five types of withholding tax in their income tax system: withholding tax on employees’ salaries, withholding tax on payments to foreigners, withholding tax on income from asset utilisation (e.g. rent, interest and dividend), withholding tax on income from service provision, and withholding tax imposed on particular industries (e.g. steel, paper, and automotive).

2.2.3 Corporate income tax in Indonesia

Currently, the statutory tax rate for corporations in Indonesia is a flat rate of 25 percent for the fiscal year 2010 onward. However, if public companies have satisfied a minimum listing requirement of 40 percent of their paid-up shares that are listed for trading on the Indonesian Stock Exchange and have met other predetermined conditions, they are entitled to have a tax cut of five percent of the standard rate. Also, to support small businesses, the government offers an incentive of a further 50 percent cut on the standard corporate tax rate that applies to small businesses that have met certain conditions.

In principle, the resident companies are taxed based on their worldwide income. However, the non-resident corporations are taxed only on their Indonesia-source income, including income related to their permanent establishment in Indonesia.

14 According to Article 17 of Law Number 7 of 1983 concerning Income Tax as lastly amended by Law Number 36 of 2008.

15 A five percent corporate tax rate cut can be granted to a public company that satisfies the following conditions:
   - At least 40 percent of their paid-in shares are listed for trading in the Indonesian Stock Exchange and these shares are placed in the collective custody of a custodian and the respective settlement institution
   - The term ‘public’ means it consists of at least 300 individuals who own the shares and each individual holds less than five percent of the paid-in shares.
   This applied condition must be maintained for at least 183 days in a tax year to obtain the five percent tax cut.
According to the Indonesian income tax law, the taxable objects are broadly defined as “income”, which is defined in Article 4(1) of the Law Number 7 of 1983 as any increase in economic capacity received by or accrued by a taxpayer from within or outside Indonesia which may be utilized for consumption or to increase the taxpayer’s wealth, in whatever name and form.

Consequently, there is no difference in the treatment of a foreign-owned subsidiary and a locally-owned entity. Hence, a company is treated as an Indonesian resident for tax purposes if its business, incorporation or domicile is within the Indonesia border. Foreign firms that carry out their business activities in Indonesia through a permanent establishment (PEs) have obligations similar to those of the resident taxpayer. Therefore, both the resident taxpayers and the PEs of foreign companies are required to settle their tax liabilities either by direct payments, third-party withholdings or a combination of both. Those foreign firms without PEs must settle their tax liabilities for their Indonesian-sourced income through a withholding mechanism via the Indonesian party that is responsible for paying their income.16

Standard accounting principles calculate taxable business profits, and at some point, the profits can be modified by the acceptable tax adjustments17. Principally, deductions are allowed for all expenditures incurred as long as the expenditures have been disbursed in order to earn, to collect and to secure the business profits.18 In practice, book-timing differences may occur if some costs have been recorded as expenses in the accounting post which cannot be claimed immediately as deductions for tax purposes.19

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16 According to Article 26 of the Indonesian income tax law number 36 year 2008.

17 The acceptable tax adjustment means a range of items that have been acceptable for being adjusted in taxable income calculation. Typically, the adjustment is made in the taxpayer’s reconciliation statement by indicating the differences between profit or loss that calculated for the purpose of accounting and the taxable income calculation.

18 According to Article 6 of the Indonesian income tax law number 36 year 2008.

19 Frequently, some permanent differences and or timing differences may occur regarding expenditures in order to calculate the final profit. Therefore, the profit reconciliation is always needed between the accounting division and the taxation division.
However, for some specialised industries and activities, different provisions may apply regarding the calculation of corporate income tax. These include specific contractual-based concessions such as Production Sharing Contracts (PSCs) and Contract of Works (CoWs). Companies that are engaged in upstream oil and gas and geothermal industries should calculate corporate income tax in accordance with their PSCs. A particular company engaged in metal, mineral and coal mining is governed by CoW when calculating its tax liabilities. However, CoWs are no longer available to new mining projects since the enactment of the Law Number 4 of 2009 concerning Mineral and Coal Mining which stipulates that general prevailing tax laws and regulations apply to the mining projects (PwC, 2017).

In the case of transfer pricing, the DGT requires that related party transactions or dealings with the affiliated companies, which includes profit-sharing by multinational corporations, should be carried out on an arm’s length basis and in a “commercially justifiable way”. Moreover, the government requires specific transfer pricing documentation to prove that the most appropriate transfer pricing method has been utilised, and the transactions made were consistent with the arm’s length principle. However, the domestic-related party transactions, in general, are outside the scope of the transfer pricing rules unless the taxpayer is subject to different tax rates, as in the cases where the transactions have been conducted with contractors in the oil and gas industry. If a company has failed to follow this requirement, the DGT is authorised to

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20 The Contract of Works or Kontrak Karya (KK) is a mining concession between the government of the Republic of Indonesia with a company to carry out mining activities excluding oil and gas in a specific period. KK was previously stipulated in the Law Number 11 year 1967 on Principal Terms of Mining before it was replaced with the new law in 2009.

21 In general, the Indonesian income tax law describes related parties as:
   a. Companies who have ownership in term of capital participation at least 25 percent either directly or indirectly upon other companies;
   b. Companies who control another company or two or more companies are under the similar control, either directly or indirectly; or,
   c. There is family relationship which is indicated either by blood relationship or by marriage.

22 As promulgated by the Regulation of Minister of Finance of the Republic of Indonesia No. 213/PMK.03/2016.

23 As promulgated by the DGT Regulation No. PER-32/PJ/2011 and the DGT Regulation No. 43/PJ/2010 concerning the application of arm’s length principle in related party transactions.
recalculate the taxable income or the deductible costs by applying the arm’s length principle\textsuperscript{24}.

Any company that has transfer pricing disputes with the DGT may file an objection or an appeal with the Tax Court. Alternatively, this taxpayer can request a double tax relief under the Mutual Agreement Procedure (MAP) article if the transactions with the related party were conducted with one of Indonesia’s tax treaty partners. Further, the Government Regulation Number 74 of 2011 provides flexibility for the taxpayer to apply for a MAP and to continue domestic resolution at the same time. However, there is a restriction: a MAP application cannot be lodged if the Tax Court has declared an end to the court hearing process. Another mechanism used to settle the related party transactions dispute is the Advance Pricing Agreement (APA) which is regulated by the Regulation of Ministry of Finance Number 07/PMK.03/2015. Once the APA has been established, it is valid for a maximum of three fiscal years for unilateral agreements and four fiscal years for bilateral agreements after the effective date.

To tackle tax avoidance, despite the non-existence of general anti-avoidance rules in Indonesia, Indonesia does have several specific measures. For example, to anticipate tax treaty misconduct by the taxpayer, the DGT requires taxpayers to confirm that their transactions have economic substance and are not designed solely to take advantage of a tax treaty’s benefit. Another anti-avoidance rule is applied by the provision of the Controlled Foreign Corporation (CFC)\textsuperscript{25}. A CFC is defined as an unlisted foreign company in which the Indonesian resident either individually or as a group holds at least 50 percent or more of the total paid in capital to that offshore company.\textsuperscript{26} All the overseas investment by the Indonesian taxpayer will be subject to this rule except for the foreign investments that have been made to the publicly listed companies because Indonesia has not had either a ‘white list’ or ‘black list’ of countries since 2009. A Debt-to-Equity Ratio (DER) mechanism is also applied to tackle the avoidance whereby the amount of tax deducted from the cost of borrowing that arises

\textsuperscript{24} The arm’s length principle is based on Article 9 of the OECD model tax convention which identified as a situation when the parties transact with each other, the condition or the fact of those parties are independent or the transaction is determined by purely market forces (OECD, 2017).

\textsuperscript{25} Stipulated in the Article 18 (2) of the Indonesian income tax law.

\textsuperscript{26} Stated in the Article 18 of the Indonesian income tax law and further regulated by the Minister of Finance Regulation No. 256/PMK.03/2008.
from debt, in general, is restricted to a maximum threshold of DER of 4:1; alternatively, the excess of the borrowing cost cannot be deductible for tax calculation purposes.

### 2.2.4 Tax administration in Indonesia

The DGT is an echelon 1 unit under the MoF, and is headed by the Director General of Taxes. In general, the DGT’s primary tasks are formulating, implementing various technical policies and establishing taxation standards at the national level. In undertaking those tasks, the DGT performs several functions such as preparing and implementing taxation policies; preparing norms, standards, procedures and criteria of taxation; providing technical guidance and supervision; performing monitoring, evaluation and reporting in taxation; performing tax administration; and performing other functions assigned by the Minister of Finance (DGT, 2015). The DGT has a head office and operational offices. The head office is located in Jakarta and comprises one secretariat, 14 directorates and four senior advisors. The details regarding the operational offices that are dispersed across Indonesia are shown in Table 2-2 below.

<table>
<thead>
<tr>
<th>Type of office</th>
<th>Number of offices</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regional Tax Office (RTO)</td>
<td>33</td>
</tr>
<tr>
<td>Large Taxpayers Office (LTO)</td>
<td>4</td>
</tr>
<tr>
<td>Medium Taxpayers Office (MTO)</td>
<td>28</td>
</tr>
<tr>
<td>Small Taxpayers Office (STO)</td>
<td>309</td>
</tr>
<tr>
<td>Tax Services Dissemination and Consultation Office (TSDCO)</td>
<td>207</td>
</tr>
<tr>
<td>Technical Implementing Unit (TIU)</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: DGT (2015)

As of 2015, the DGT had 37,987 employees, 70.54 percent of whom were men. Figure 2-6 below shows that around 64 percent of the DGT’s employees work on Java Island since Java is the most populous area in Indonesia and most of the economic activities take place on this island. Figure 2-7 below shows the composition of the DGT’s workforce according to their function namely, echelon official, administration, tax
auditor, appraiser and computer administrator. The figure indicate an imbalance proportion between the personnel that appointed for administrative and the non-administrative. As evident, 74 percent of employees have an administrative function, while tax auditors constitute only 12 percent of the total employees. As argued by Korte (2013), this is not an ideal situation for a tax administration and has negative consequences in terms of tax compliance.

FIGURE 2-6 THE DGT EMPLOYEES’ DISTRIBUTION BY LOCATION
Source: DGT (2015)

FIGURE 2-7 THE DGT EMPLOYEES’ COMPOSITION BY FUNCTION
Source: DGT (2015)

Echelon official is a higher level official who was appointed to head a section, division, tax office or regional office in the DGT’s organizational structure. The Echelon rank is divided into four level: Echelon 1 (the director general), Echelon 2 (directors, senior advisors, head of regional office and head of TIU), echelon 3 (deputy directors, head of division and head of tax office) and echelon 4 (head of section, head of sub-division and head of TSDCO). Appraiser is an official who appointed as real estate appraiser. The main task of appraiser is to value land and building in order to determine its market value for taxation purposes. See Appendix B for the DGT organizational structure information.
2.3 Compliance issues in Indonesia

Ikhsan et al. (2005) and Arnold (2012) argue that tax compliance is a significant issue in Indonesia and is still unresolved, despite the tax reform that came into force in 1983 (Heij & Griffiths, 2007). The DGT as the tax administrator in Indonesia has recognised that compliance issues constitute major challenges that need to be rectified (DGT, 2017). Considering the importance of corporate roles as discussed in Section 2.2.2, it is conceivable that the compliance issue in the corporate sector will have a huge impact on State revenue. Therefore, this section discusses four indicators related to the problem of corporate tax compliance in Indonesia.

First, despite its significant contribution to the state budget, (76 percent on average for the last seven years) the Indonesian tax system experiences low tax revenue collection. Arnold (2012) claimed that Indonesia’s tax ratio is lower than those of its G20 peers and even lower than those of their neighbouring countries like Malaysia or Thailand. \(^{28}\) IMF (2017) supported the claim, pointing out that, in general, the Indonesian government revenue has trailed behind its peers in mobilising revenue and the gap was widening after the global financial crisis in 2008 as shown in Figure 2-8

\(^{28}\) Tax ratio is defined as tax to GDP ratio which means the comparison between tax revenue and the Gross Domestic Product. This ratio is frequently used as a measure of the amount of taxes paid across the years (IMF, 2011).
above. Figure 2-9 below indicates a comparison of tax ratio between Indonesia and other countries in Asia, again demonstrating that Indonesia has lagged behind its neighbours in terms of its tax collection effectiveness, consequently, the availability of infrastructure, social welfare and other public interests will suffer for its financing.

Another issue is the low tax productivity.²⁹ Figure 2-10 shows, that compared to their neighbour countries, the productivity in collecting corporate income tax in Indonesia was considered low which means the collection rate is below its potential (Ikhsan et al. 2005). The IMF (2017) argues that such low productivity could be caused by weakness in tax administration or inappropriate exemptions. The study of Bayraktar, Le and Moreno-Dodson (2012) using data from 110 countries from 1994 to 2009 also pointed out that Indonesia is categorised as a country with a low collection rate and low tax efforts, indicating that Indonesia is still struggling to collect tax revenue and the collection is below its capacity.

²⁹ The corporate income tax (CIT) productivity is defined as the ratio of CIT revenue in percent to the top bracket of CIT rate (IMF, 2017) or it can be interpreted as the CIT ratio adjusted for the CIT statutory rate. In this case as indicated in Figure 2-10, the Indonesia tax productivity efficiency is about 0.17 which means the authorities only collect 17 percent CIT revenue compared to its tax rate benchmark at 25 percent, or Indonesia’s CIT productivity in 2015 was about four percent of its GDP.
Regarding corporate tax compliance, Figure 2-11 demonstrates the level of compliance of annual filing ratio for corporate income tax was only around 50 percent on average from 2012 to 2015, which is low since the respective legislation requires a timely lodgement of tax returns by corporate taxpayers. It is worth noting here that Figure 2-11 shows the level of compliance in terms of the timeliness of reporting only, irrespective of the accuracy of the declared income in the tax returns; even so, the ratio is only about 50 percent on average. However, while filing compliance remains low, it is increasing over time, thus in terms of filing ratio the future is encouraging.
Finally, the last issue is related to the sign of non-compliance of corporate taxpayers. In 2015, Dr Bambang Brodjonegoro, the Indonesian Minister of Finance, stated that 4,000 foreign companies had never paid their income tax since their establishment in Indonesia, which meant that several of those companies had not paid income tax for 25 years, although they were operational (Gandhi, 2015). These foreign companies were suspected of using non-compliance schemes to avoid taxes such as transfer pricing or tax avoidance arrangements. A report from the OECD (2013) stated that the escalation of tax avoidance by multinational companies had become a global trend, with the Economist (2014) claiming that the developing countries suffered more as a result of this avoidance. Currently, the conduct of large corporations has come under scrutiny by tax authorities in various countries since the Panama Papers case was exposed. ICIJ (2017), the organisation responsible for leaking the Panama Papers, reported that there are at least 4,300 Indonesian companies or their affiliations with offshore accounts in tax haven countries thanks to the assistance of a single law firm, Mossack Fonseca. Hence, as stated by Tomkins et al. (2001), these tax avoidance issues posed more challenges to the tax authority in collecting taxes as businesses are now operating more globally and have more complex structures.

2.4 Chapter Summary

This chapter discussed the issues that provide a contextual research background for the study. It reviewed the Indonesian tax system particularly in regard to revenue and the tax structure in Indonesia, emphasising the importance of taxes as the source of sustainable financing and the dominance of the income tax as the main contributor of tax revenue in Indonesia. Regarding income tax and corporate income tax in Indonesia, the chapter described the major features of the law such as income recognition, withholding tax system, the tax rate, dispute settlement, and anti-avoidance measures. Under the topic of tax administration in Indonesia, the chapter described the main job of the DGT, the type of offices and the composition of the DGT workforce. This chapter also reviewed the issue of tax compliance in Indonesia by exploring four aspects that posed more challenges to the tax authority in its attempts to improve compliance.
CHAPTER 3
LITERATURE REVIEW

3.1. Introduction

This chapter discusses the relevant concepts that are reviewed in this study. In Section 3.2, tax compliance, tax avoidance and tax risk are explained in detail. Section 3.3 reviews the factors influencing corporate compliance behaviour. This section consists of three subsections in which economic factors, non-economic factors and corporate characteristics are discussed. Sections 3.4 and 3.5 describe the responsive regulation approach and compliance risk management. Section 3.6 discusses the situation of tax administration in developing countries while Section 3.7 explores previous corporate tax compliance studies and the knowledge gap in the literature. Section 3.8 concludes the chapter.

3.2 Developments of relevant concepts in tax compliance literature

An understanding of relevant concepts related to tax compliance behaviour is necessary as the stance taken by taxpayers - whether to comply or not comply - is likely to be affected by their attitude toward the law and the government. Consequently, the level of compliance might result from the taxpayers’ rationale regarding the acceptable risks they are willing to take. Hence, both taxpayers and the authority should manage the tax risks properly to prevent any potential threat to themselves with respect to their own standpoint. Accordingly, a discussion of the issues of tax compliance, tax avoidance and tax risk is vital in attaining a better understanding of the nature of corporate compliance behaviour. As McKerchar (2003) noted, the clarity of definitions is essential in a tax compliance study.

3.2.1 Tax compliance

Tax compliance could be seen as a continuum of definitions ranging from a narrow perspective of law enforcement approach to the wide version of the taxpayer decisions to comply with tax laws (Brown & Mazur, 2003). Andreoni, Erard and Feinstein (1998) argue that tax compliance is a fluid concept that could be approached from multiple perspectives. For example, in the public finance area, tax compliance is related to
equity, efficiency and incidence issues; in terms of labour market behaviour, occupational choices or labour supply might be affected by the degree of non-compliance activities. In organisational theories, tax compliance is related to the principal-agent issue where the challenge is to design an effective institution to enforce tax laws although they have limited capacity to enforce the laws.

Several scholars have offered their own definitions of tax compliance (see for example Cialdini, 1989; Roth & Scholz, 1989; Alm, 1991; James & Alley, 2002; Brown & Mazur, 2003; McKerchar, 2003). Long and Swingen (1991) view tax compliance as the result of the process of interaction between the authority and taxpayers. The social psychologist views tax compliance as powerfully influenced by six major compliance principles as part of social motivations-commitment; these principles are: consistency, reciprocity, social validation, authority, scarcity and friendship or liking (Cialdini, 1989).

Another definition of tax compliance was proposed by Alm (1991, p.577): "reporting all income and paying all taxes in accordance with the applicable law, regulations, and court decisions." While Kirchler (2007, p.21) offers his definition of tax compliance as "the most neutral term to describe taxpayers' willingness to pay their taxes." James and Alley (2002, p.32) defined tax compliance as "the willingness of individuals and other taxable entities to act in accordance within the spirit as well as the letter of tax law and administration without the application of enforcement activity"; this compliance has two perspectives which are voluntary or compulsory behaviour as required by the law. Meanwhile, Weber, Fookend and Herrmann (2014, p.5) suggest a simple definition of tax compliance: “the absence of tax evasion”.

Consequently, defining taxpayer compliance is not a simple task. However on a more general note, tax compliance was defined by Roth and Scholz (1989, p.2) as “the timely filing of accurate tax return” and in a broader sense, James and Alley (2002, p.29) added “the degree to which taxpayer comply with tax laws”. Brown and Mazur (2003) divided tax compliance into three components of compliance which are the filing, the reporting and the payment. They point out that these three components are mutually exclusive and collectively shaped by taxpayer compliance. For this reason, a panel that was established for taxpayer compliance research purposes in the United States
adopted the following definition of compliance with the underlying assumption that the taxpayers’ motivation is *ceteris paribus* as follows (Roth, Scholz, & Witte, 1989, p.2):

“Compliance with reporting requirements means that the taxpayer files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the Internal Revenue Code, regulations and court decisions applicable at the time the return is filed.”

Unfortunately, this definition does not mention the obligation of taxpayers to pay their taxes on time and to keep appropriate records. Accordingly, McKerchar (2003, p.225) argued that a broader definition for research purposes is one that includes the timing of tax payments and proper record keeping, and should be as follows:

“Taxpayer files all required income tax returns accurately and at the proper time, pays any outstanding taxes as they fall due and maintains all required records. The accuracy of the return and the records required are determined in accordance with the prevailing legislation (both tax and otherwise), rulings, return instructions and court decisions.”

Moreover, it can be reasoned that the taxpayers can be said to be complying when they are appropriately declaring their income, properly paying their taxes and thoroughly abiding by tax laws. Ohms, Olesen and Khin-Carter (2015, p.428) identified tax compliance as “the actions of a taxpayer in engaging in the set of statutory obligations cast upon them in respect of their annual total tax liability to register, record and report, return and enable assessment, pay and participate in any post-assessment adjustment process”.

Hence, based on the definitions above, tax compliance could be categorised according to: (1) the conceptual definition (for example: Cialdini, 1989; Long & Swingen, 1991; James & Alley, 2002; Weber et al., 2014) and, (2) the practical definition (for example: Roth & Scholz, 1989; Alm, 1991; Brown & Mazur, 2003; McKerchar, 2003; Ohms et al., 2015). In short, the conceptual definition emphasises the willingness of taxpayer to comply voluntarily while the practical one focuses on the administrative fulfilment of taxpayer obligations. Meanwhile, tax compliance in Indonesia, in general, follows the
OECD (2014, 60) definition of tax compliance which is: "(i) to register for tax purposes; (ii) to file tax returns on time; (iii) to correctly report tax liabilities; and (iv) to pay taxes on time". However, the Indonesian version categorises tax compliance into two major groups: (i) ‘formal compliance’ that refers to criteria registration and filling and, (ii) ‘material compliance’ or substantive compliance that refers to reporting and payment criteria (Harinurdin, 2009). Therefore, as it is one of the focal points of this study, a tax compliance definition should be established for the relevant context of this research and with respect to the body of literature.

In terms of complying with the tax law, because of decisions or actions taken by the taxpayer, non-compliance might occur either intentionally or unintentionally (Roth & Scholz, 1989). Further, Weisbach (2003) argued that the complexity and ambiguity of tax laws may have escalated the incidence of non-compliance behaviour. Consequently, a taxpayer may be non-compliant despite the intention to comply or vice versa.

The issue of non-compliance has become a central problem that prevents the tax authority from achieving its goals because not all taxpayers are willing to declare their income and pay their taxes accordingly. Kirchler, Macjejovsky and Schneider (2003) argued that some taxpayers do not see that compliance with the tax law is one of their obligations as good citizens. Hence, Leviner (2009, 425) argued that “tax noncompliance is a serious and complex problem, subject to a full range of causes and influences” and many scholars agree that tax noncompliance is a universal concern encountered by most revenue administrations (for example, Allingham & Sandmo, 1972; Andreoni et al., 1998; Franzoni, 1999; James & Alley, 2002; Kirchler et al., 2003; Eisenhauer, 2008). At this point, the tax authority also needs to identify the factors that motivate taxpayers to either comply or not comply. Moreover, Walpole & Evans (2001) argued that the effort to discourage non-compliance is not the responsibility of the government only; it is also a social responsibility because, arguably, the community’s welfare depends mainly on adequate tax revenue.
3.2.2 Tax avoidance

In a broad sense, Braithwaite (2005, p.236) defined tax avoidance as a "plan or arrangement established for the sole or dominant purpose of avoiding tax". Strategies for reducing the payment of certain taxes may range from small-scale tax planning at one end to very aggressive tax planning at the other end (Hanlon & Heitzman, 2010). In accounting terms, this means the decrease of specific tax liabilities through cash flow transactions or pre-tax income arrangements (Dyreng, Hanlon & Maydew, 2008; Ki, 2012; Kang & Ko, 2014).

However, on the sensitive issue of the definition, Hanlon & Heitzman (2010, p.152) argued that the term “tax avoidance” lacks a general definition as it might mean a “different thing to different people”. The OECD admitted the difficulty of defining tax avoidance by stating that it is "a term that is difficult to define but which is generally used to describe the arrangement of a taxpayer’s affairs that is intended to reduce his tax liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow.” This indicates the widespread concern and interest in the “magnitude, determinants and consequences” of tax avoidance. Further, Hanlon & Heitzman (2010) argued that the adoption of a broad definition is to circumvent any intricacies associated with a narrow definition and to cover the broad tax avoidance spectrum. Therefore, the concept of tax avoidance could also encompass all conduct that reduces the tax burden irrespective of the legality factor (Dyreng et al., 2008). Thus, due to the significance of the notion, Hanlon & Heitzman (2010) asserted that more research is required in this particular area in order to establish a universally accepted and comprehensive definition.

In the literature, the term ‘tax avoidance’ is sometimes used interchangeably with tax aggressiveness, tax planning, tax management and tax sheltering (See for instance: Chen, Chen, Cheng & Shevlin, 2010; Lanis & Richardson, 2011; Minnick & Noga, 2010; Tang & Firth, 2011). However, some prefer a separate and more precise description of each term although they are all under the umbrella of ‘tax avoidance’. Some scholars believe that tax avoidance is legal and morally acceptable because it is a planned

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course of action to save taxes in a way that does not contravene the respective law (for example, Franzoni, 1999; James & Alley, 2002; Kirchler et al., 2003; Sandmo, 2005). For example, John and Alley (2002) argued that tax avoidance should not be associated with taxpayer compliance as the taxpayer is following “the spirit and the letter” of tax law. Although Weber et al. (2014) recognised the difference between tax avoidance and tax evasion, nevertheless to some extent they suggest that avoidance is associated with taxpayer compliance. Hence, tax avoidance implies that taxpayers are taking advantage of loopholes in the tax law to decrease their tax liabilities, which is considered as legal behaviour.

On the other side of the tax avoidance spectrum, Lisowsky (2010) defined corporate tax sheltering as a transaction without economic substance, the purpose of which is to avoid taxes or to set up a particular transaction by exploiting loopholes in the tax law to evade taxes. In the similar vein, Bankman (2004) describes tax sheltering as a transaction which is unrelated to the purpose of a normal business operation, and the objective of this action is to avoid tax liabilities contrary to the intent of tax laws. Therefore, tax sheltering could be regarded as an aggressive form of tax avoidance viewed by some as an illegal activity. Given the circumstances of tax sheltering and tax avoidance itself, moral judgement can be exercised to evaluate the opposing views even though moral judgment itself is problematic given its subjective nature (Mears & Webley, 2010).

At one end of the tax avoidance spectrum, tax evasion is often associated with tax fraud and many scholars perceive tax evasion as an immoral and illegal attempt to cheat taxes (Franzoni, 1998; James & Alley, 2002; Kirchler et al., 2003; Sandmo, 2005). The OECD defines tax evasion as the activity that "is generally used to mean illegal arrangements where liability to tax is hidden or ignored, i.e. the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities." This evasion refers to cases where the business takes deliberate action to evade taxes with or without assistance from external parties. The steps to cheat may include but are not limited to non-filing of tax returns or, filing tax returns with understated income or overstated expenses or filing a tax return with underpayment

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of taxes (Murphy, 2004b). A remarkable example of a tax evasion case is that of the Enron Corporation which employed sophisticated accounting schemes and tax havens to support their illegal activities (Slemrod, 2004).

In particular, although the aim of tax avoidance is to reduce the financial burden in consideration of company profitability, there are potential high costs of this action that arise from various parties such as the agency conflict with the taxation authority and the consequences of penalties (Boussaidi & Mounira, 2015). In this light, Desai and Dharmapala (2006) argued that tax avoidance is typically characterised by complicated and obfuscated transactions that are difficult to detect. Accordingly, transactions that are related to tax avoidance activities run parallel with the future tax risk. Here, the term ‘tax risk’ is associated not only with the possibility of penalties but also the likelihood of losing profitable opportunity. Hence, tax avoidance may escalate tax risks because of the companies’ exposure to the unpredictable business outcome.

The tax avoidance phenomenon has become a significant global issue (Braithwaite, 2005). As tax avoidance and the tax evasion are pervasive problems, the public need to be alarmed by the fact that non-compliance may result in less revenue than expected in the government budget (Eisenhauer, 2008). This revenue loss, according to Franzoni (1999) may cause severe damage to the public sector by threatening its capacity to finance operational activities. A recent report from the OECD (2014) mentions that base erosion and profit shifting (BEPS) has become a global trend to avoid taxes for multinational companies that harm developed and developing countries. It has been estimated that the amount of corporate tax avoidance is about a quarter of the total corporate profits in developed countries, and the number is more substantial for the developing ones (Economist, 2014).

3.2.3 Tax risk

Wunder (2009, p.16) cited Arlinghaus (1998) who admitted that there is no widely accepted general definition of tax risk; nevertheless, he offers the following understanding of tax risk:
the likelihood that tax outcome differs from what is expected, due to a variety of reasons, for example, the judicial process, changes in the law, changes in business assumptions, an increased intensity of audits, and uncertainty in the interpretation of the law; and any action emanating from the tax function that subjects the company to adverse publicity.”

Goodman (2004) argued that business views tax risk as part of the internal control objective. The goals of a company’s internal control as stated in the Committee of Sponsoring Organizations’ (COSO) Enterprise Risk Management – Integrated Framework (COSO Framework) include effectiveness and efficiency of operations, the reliability of financial reporting, and compliance with laws and regulations. The latter depends considerably on the company’s tax risk management strategy.

Arlinghaus (1998) emphasised that the main determinant of tax risk occurrence is the external factor. However, the internal control factor, for example, may cause tax risk to emerge as well, so both factors have equal significance (Goodman, 2004). Therefore, tax risk may result in the unpredictability of the corporate outcomes regardless of the tax risk sources (Miller, 1992). The PricewaterhouseCoopers’ (2004) treatise on the approach to tax risk management includes the identification of specific risk areas and generic risk areas. Neubig and Sangha (2004, 114) offered a broader definition of tax risk as the accumulation of “all sources of risk that may create an unexpected outcome from a tax position.” Hence, a firm’s success in handling tax risk depends on the management’s ability to sustain its tax position over time and can be measured by the standard deviation of the effective tax rates cost (Guenther, Matsunaga & Williams, 2013).

However, inadequate tax risk management in a company could pose governance problems along with the potential tax penalties imposed by the authority (Chen et al.,

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32 PricewaterhouseCoopers (2004, 4) identifies four specific risk areas which are: (1) Transactional risk (e.g., acquisitions, mergers), (2) Operational risk (e.g., new business ventures, new operating models, new operating structure), (3) Compliance risk (e.g., weak records and controls, data integrity issues, legislative changes) and, (4) Financial accounting risk (e.g., changes in systems and policies) and three generic risk areas which are: (1) Portfolio risk (e.g., combination of any of the risks), (2) Management risk (e.g., changes in personnel, new/inexperienced resources) and, (3) Reputational risk (e.g., revenue authority investigation, press comment, legal actions).

2010; Lanis & Richardson, 2011; Armstrong et al., 2012). In this light, Desai and Dharmapala (2008) pointed out that a higher tax risk imposes additional agency costs on the shareholders. Hence, managers take the opportunity to arrange more complex tax planning to avoid detection and for their own interests at the cost of shareholder interests. In a different scenario, the managers should balance the interests of their various stakeholders such as the shareholders, government and society with the company’s goal of maximising profits. Nevertheless, all this pressure might force managers to escalate the level of tax risk either intentionally or otherwise (Erle, 2008).

However, on the government side, the tax authority has a distinct attitude towards the term ‘tax risk’, for example, the Internal Revenue Service (IRS). The IRSAC33 (2008, p.2) defined tax risk as:

“any event, action, or inaction in tax strategy, operations, oversight reporting, or compliance that either adversely affects LMSBio’s34 collection or business objectives, or results in an unanticipated or unacceptable level of oversight reprimands, lost appeals, diminished collections, harm to reputation, lost opportunities or reporting exposure.”

The UK authorities (HRMC, 2007, P.5) defined the term ‘tax risk’ for large corporations as “a risk that a customer will not pay the right amount of tax or duty at the right time” and further:

“A tax compliance risk may be an identified tax issue, where HMRC and the customer may not agree about a particular tax analysis set out in a return or declaration. Or it may be a less specific uncertainty about whether tax returns and declarations are correct which may lead to an issue being identified.”

Along with the IRS and the HRMC, other tax authorities such as Australia’s and those of several countries in Europe have established effective definition in order to manage susceptibility to tax risk in their jurisdictions. The authority might encounter several substantial risk threats such as large-scale evasion, transaction complexity, massive

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33 The IRSAC is the Internal Revenue Service Advisory Council.
34 The LMSB is a division under the IRS organizational structure that in charge for Large and Mid-Size Business.
aggressive tax planning, and a pervasive globalisation effect that require fast response and thoughtful consideration (Hasseldine, 2007). Since the tax risks effect is more likely to have impacts on the aims of collecting revenue, the tax authorities in several countries have issued their guidelines for tax risk management. For instance, the ATO issued the *Large Business and Tax Compliance Guidelines* (ATO, 2006), the European Union published *Risk Management Guide for Tax Administration* (EC, 2006), the HMRC issued *Tax Compliance risk management: guidance for Large Business Service (LBS) customers and staff* (HRMC, 2007), and the IRS established Large Mid-size Business Subgroups (IRSAC, 2008).

Therefore, the corporate taxpayer and the tax authority as regulator see task risk differently although the underlying tenet here is that tax risk needs to be managed appropriately by both parties in order to pursue their objectives.

### 3.3. Factors influencing corporate compliance behaviour

The body of literature indicates that past studies have mainly focused on individual rather than corporate tax compliance, although the latter has been gaining traction in recent years. The case of Enron, Panama Papers and the efforts undertaken by the OECD and many tax authorities to manage globalised aggressive tax planning have given greater significance to the study of corporate tax compliance. Nevertheless, it could be argued that, to some extent, corporate and individual compliance have many characteristics in common since a corporation is a fictitious entity formed by people and the managers, in fact, do determine the level of compliance of their corporation (Joulfaian, 2000). The managers apply their own values, attitudes and norms that may influence their corporations’ compliance (Koester, Shevlin & Wangerin, 2013). One notable difference is that corporate decisions are made by a group of individuals with varying degrees of influence which results in an action that is more logical than that of an individual (Ariel, 2011).

Therefore, in this study, the researcher also refers to the body of literature that relates to those individual compliance determinants that are considered relevant since, in terms of norms or trust, for instance, the findings are similar for both the corporation and the individual. Moreover, since tax compliance behaviour is not only complicated...
but also highly context-dependent as well, there is still no agreement among tax researchers regarding the determinant that has the most impact (McKerchar & Evans, 2009). The nature of tax as a social phenomenon has resulted in tax compliance behaviour that is affected by different knowledge of different domains ranging from law, economics, accounting to politics and social policy (Lamb, 2005).

It is acknowledged that the factors influencing corporate tax compliance that are discussed in this chapter are derived from the study conducted by van der Hel-van Dijk and Siglé, (2015). They are: (i) economic factors, (ii) socio-psychological factors and, (iii) corporate characteristics as shown in Table 3-1 below. However, it should be noted that this is not a rigid categorisation since the boundaries between factors are somewhat blurred; for example, the factor of profitability could be placed into the category of economic factors instead of corporate characteristics.

### TABLE 3-1 FACTORS INFLUENCING CORPORATE TAX COMPLIANCE

<table>
<thead>
<tr>
<th>Economic factors</th>
<th>Socio-Psychological factors</th>
<th>Corporate characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Penalties</td>
<td>Personal norms</td>
<td>Board of directors’ composition</td>
</tr>
<tr>
<td>Detection probability</td>
<td>Social norms</td>
<td>Tax risk management</td>
</tr>
<tr>
<td>Tax rate</td>
<td>Fairness</td>
<td>Ownership</td>
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<tr>
<td>Manager compensation</td>
<td>Trust</td>
<td>The use of tax advisors</td>
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<td>Risk appetite</td>
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<td>Profitability</td>
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<td>Complexity of the law</td>
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<td>Uncertainty</td>
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</tbody>
</table>

Source: Modified from van der Hel-van Dijk and Siglé, (2015)

#### 3.3.1 Economics factors

The economic factors originated from the work of Becker (1967) who proposed the economics-of-crime model as an approach to explaining the decision not to comply according to the economic framework. It is based on the rationality that tax compliance is affected by the economic cost-benefit decision (Kinsey, 1992). The economic factors sometimes also associated with deterrence theory. Accordingly, in the context of corporate compliance, several factors from the corporation’s point of view are involved as determinants; they include tax rate, penalties, book-tax conformity, detection probability, manager compensation, and risk appetite. Hence, in general, taxpayers decide to comply with the law if it makes them financially better off
based on their rational cost-benefit calculation (Allingham & Sandmo, 1972; Yitzhaki, 1974).

However, Chen and Chu (2005) argued that the non-compliance decision of a corporation is more complicated, unlike the individual whose decision to evade depends on personal assessment. Conversely, the corporation’s decision relates to principal-agent model as it depends on the agency framework or the relationship between manager and business owner. They further argued that a corporation might engage in evasion if the risk of being detected is only small. Consequently, there may be less evasion in those corporations which have more hierarchies and have established firm internal control.

Penalties

Becker (1967) argued that the threat of punishment or penalties is significant in reducing illegal behaviour, valid for any violations and encompassing many misdemeanours and crimes ranging from traffic violations, robbery and murder to tax evasion. In the context of taxation, the threat of punishment is seen as a coercive approach that forces compliance by imposing penalties. Becker’s basic idea was modified by Allingham and Sandmo (1972) who added the tenet that a taxpayer is a rational actor who sought to maximise their utility so that penalties can be used to force them to comply. They used variables such as tax rate, the probability of detection and penalty as the proxies of the threat of punishment with the expected outcome that the decision made by the rational taxpayer depends on the perception of the likelihood of being audited. Hence, the study of Allingham and Sandmo that focused on the deterrence effect and placed more emphasis on the issue of tax evasion or non-compliance, was used as the basis for later similar work on using deterrence to determine compliance (See for example: Kolm, 1973; Christiansen, 1980; Spicer & Thomas, 1982; Scotchmer & Slemrod, 1989; Alm, Jackson & McKee, 1992; Torgler, 2007; Li, 2010).

In the context of penalties, there are variations in the use of penalties as a deterrent. Yitzhaki (1974) proposed that a penalty would be more effective if imposed on the evaded taxes instead of on the undeclared tax. He argued that there are no
contradictory effects on such impose with the assumption that the taxpayer fully risk-averse, a notion that deemed as more realistic (Devos, 2013). Meanwhile, other scholars found that the level of penalty severity affected taxpayer’s compliance (Beck & Jung, 1989; Kirchler, Kogler & Muehlbacher, 2014). Regarding the subject of who incurs a penalty, Crocker and Slemrod (2005) argued that imposing a penalty on tax managers rather than on the corporation is more effective in reducing corporate non-compliance.

**Detection probability**

One of the variables used in Allingham and Sandmo’s (1972) study was the probability of detection. They constructed a tax compliance model that illustrated how the taxpayers are maximising their utility given the available choices. In the model, they argued that a taxpayer is more likely to report less actual income if the probability of detection is less than the expected utility. The notion that the likelihood of being caught by the authority affects compliance was also confirmed by Chen and Chu (2005) and Morse, Karlinsky and Bankman (2009) who found in their studies that a taxpayer might consider evading if the risk of being detected for the infringement was small. A variation of the study regarding audit as a deterrent that influences compliance was offered by Dubin, Graetz and Wilde (1992) and Alm, Kirchler and Muehlbacher, (2012), while Strumpel (1969) argued that the rigidity of assessment during the audit may influence the compliance as well. However, the results of the study conducted by DeBacker, Heim, Tran and Yuskavage (2013) contradicted those of previous studies regarding the effectiveness of audit as a deterrent. They found that, in the long run, the post-audit corporation becomes more tax aggressive than prior to the audit by reducing their effective tax rate by around eight percent.

**Tax rate**

In simple terms, the tax rate is generally related to the taxpayer’s willingness to comply. An increase in the tax rate makes it more profitable for taxpayers to seek ways to lower their effective rates, thereby making them less compliant (Downs & Stetson, 2014). These researchers found that taxpayers are more willing to be non-compliant when a tax rate increase made it more profitable for them to evade taxes. The finding
of Down and Stetson (2014) is supported by the concept of the taxpayer as a logical entity that always sought to maximise its utility (Becker, 1967; Allingham & Sandmo, 1972; Yitzhaki, 1974; Kinsley, 1992).

Regarding the issue of the tax rate in the context of corporate taxpayers, the multinational companies are always seeking ways to maximise their tax savings, one of which is to make use of places that offer lower tax rates. Slemrod (2001) argued that the MNCs take full advantage of tax havens to minimise their ETR by using a global tax planning strategy. Rego (2003) found that the United States’ MNCs have a lower ETR than the domestic ones since they are more capable of avoiding their taxes. The tax haven is frequently used by MNCs who direct their income from a foreign source to a place with a lower tax rate rather than repatriating this income and being taxed at a higher rate (Desai, Foley & Hines, 2006). In another study, Desai, Dyck and Zingales (2007) posited that a country with a high corporate tax rate and poor enforcement is more likely to have a greater incidence of tax evasion.

Manager Compensation

The manager plays a significant role in determining a firm’s compliance. By reducing the firm’s ETR thereby maximising its profits, managers are looking after the interests of the shareholders as well as their own, particularly if they receive bonuses for their efforts. Crocker and Slemrod (2005) argued that non-compliance can benefit the manager’s self-interest. This notion was supported by other studies’s findings that if managers receive bonuses for performance, this might encourage them to seek any means of reducing the firm’s ETR, whether it be legal or not, and this would decrease the firms’ level of compliance (Philips, 2003; Rego & Wilson, 2012; Powers, Robinson, & Stomberg, 2013). An empirical study conducted by Taylor and Richardson (2014) on the dataset of 200 listed Australian companies from 2006 to 2010 indicates three factors that have strong relationships with corporate non-compliance: (i) the executives’ tax expertise, (ii) the bonus-based performance packages, and (iii) the company status with many international transaction arrangements.
Risk Appetite

Van der Hel-van Dijk and Siglé (2015) argued that theoretically, risk appetite is a principal factor for corporate compliance since slight changes in the appetite may have a profound effect on the compliance. Further, they believe that many large businesses have a formalised business strategy with a formalised risk appetite included. However, a formalised risk appetite has a disadvantage as it places the business in a potentially fragile position of non-compliance by formally encouraging the firm to minimise its tax inefficiencies. As Deloitte (2008, 10) put it, firms will experience, “tax inefficiencies or missed opportunities [are] resulting from low-risk appetite.” To overcome the problem caused by risk appetite, Neubig and Sangha (2004) suggested that board of directors to have clear guidelines regarding their business risk appetite, and an adequate risk management strategy is needed to align the “risk-reward-reputation” preferences of all stakeholders.

Moreover, regarding risk appetite, Blakelock and Whitney (2015) noted that the role of business owners cannot be underestimated because of their risk acceptance level which is influenced by two factors: (i) the owner’s shares in the business and, (ii) the innate characteristics of the business owner such as the unwillingness to have a conflict with the authority. If the business owner becomes a greater risk-taker, then the business is likely to have a greater risk appetite.

Complexity of the law

Cuccia and Carnes (2001) explored the relationship between tax complexity and tax equity perceptions with identical economic consequences. The results indicated that the complexity of regulations might encourage taxpayers to engage in non-compliant behaviour. It has been suggested that the complexity of regulations is one factor that influences compliance. Further, van der Hel-van Dijk and Siglé (2015) argued that this complexity may confuse taxpayers and may lead to unintentional non-compliance. However, the more knowledgeable and sophisticated taxpayers may take the opportunity to exploit this complexity for their own gain, thereby increasing their non-compliance (Agha & Hauton, 1996). On the other side, the complexity of
regulations poses problems for the tax authority in terms of accurate execution and making the correct decision as required by the law (Kirchler, 2007).

Ambiguity and complexity in the law are frequently viewed as a combination factor that negatively affects compliance (Erle, 2008; Agha & Haughton, 1996; Kirchler, 2007; Cuccia & Carnes, 2001; Sandmo, 2005). Ambiguity increases the likelihood of a deliberate misinterpretation of the law and therefore increases the risk of non-compliance (Erle, 2008). Ambiguity in the law can also make it difficult for the taxpayer to understand it, and may lead to unintentional non-compliance (Agha & Haughton, 1996).

**Uncertainty**

The empirical study conducted by Casey and Scholz (1991) showed that taxpayers’ decisions are sensitive to how the information uncertainty is presented. Information uncertainty relates to precise information regarding the probability of detection, the correctness of the law interpretation, the severity of penalties and the rigidity of the conducted audit. As Casey and Scholz (1991, p.840) put it “ambiguity and vagueness effects suggest that compliance decisions are affected by the degree of imprecision in estimates of the probability of detection”.

Uncertainty could result from the issue of regulatory overlap which is a greater problem in the developing economies. If there is regulatory overlap among various institutions in a country, this creates confusion and uncertainty for business (O’Callaghan, 2010). Previous studies confirmed that regulatory overlap creates a waste of resources (Ahdieh, 2006; Aagaard, 2011; Li, 2015; Middleton, 2015). Aagaard (2011) further indicated that regulatory overlap, in general, is caused by conflict, complexity, duplication and lack of coordination. Therefore, the factor of uncertainty plays a role in determining taxpayer compliance behaviour (Taylor & Richardson, 2013; van der Hel-van Dijk & Siglé, 2015) since taxpayer maintain their favourable tax position in anticipating uncertainties even though their precarious tax position is inclined to be challenged.
3.3.2 Non-economic factors

The economic factors alone cannot explain the complex phenomenon of taxpayer compliance behaviour. It could be argued that the corporation and the individual are similar in some respects since a corporation is an entity comprised of people and the behaviour of a corporation is most likely influenced by the attitude of its managers (Joulfaian, 2000; Ariel, 2011; Koester et al., 2014; Olsen & Stakelberg, 2015). It also has been known that people’s response to risk usually is not based on their utility maximisation (Kahneman & Tversky, 1979). Instead, people tend to be risk-takers when they are facing losses, and in the opposite situation, they are risk-averse. Moreover, the characteristics of taxpayers regarding risk preferences also affect their decision to comply (Triverdi, Shehata & Lynn, 2003). Hence, psychological and social factors with the fiscal psychology models, although non-economic, also influence decisions regarding compliance. Hence, it can be assumed that taxpayers are not wholly independent and always maximising their utility but, in fact, their actions are influenced by their various attitudes, norms and roles (Elffers, Weigel & Hessing, 1992).

Personal norms

Although an individual in a firm may decide his/her firm’s action based on firm’s policy, it is recognised that the decision made to some extent is affected by their personal norms. In this case, Ajzen and Fishbein (1980) believed that an individual is aware of his/her actions and their implications and they concluded that the intention to engage in a certain behaviour is determined by two factors: the individual’s attitude and the social norms. Later Azjen (1991) argued that that when an individual is planning about whether or not to perform a certain action, s/he considers whether it can be achieved successfully. In a subsequent study, Fishbein and Ajzen (2010) explained that besides intention, the factor of perceived control and self-efficacy are significant in determining an individual’s behaviour. It is essential to understand these factors that influence individual behaviour as the moral standards of managers affect their corporate tax behaviour (Law & Mills, 2017).
Several more recent studies found a relationship between the managers’ characteristics and their corporate behaviour (Law & Mills, 2017; Kubick & Lockhart, 2017; Chyz, 2013; Gaertner, 2014; Olsen & Stekelberg, 2015). Law and Mills (2017) conducted a study of 1,500 managers listed in the ExecuComp database from 1992 to 2011 and who had a military background. Their study demonstrated that managers with past military experience pursue less tax avoidance and undertake less aggressive tax planning strategies. These ex-military managers’ companies on average pay USD one to two million more in corporate taxes per firm each year. Chyz (2013) conducted a study with a sample of 1,055 executives who had experience in personal tax evasion. His study result showed that these managers were positively associated with corporate tax sheltering activities. The companies headed by these managers also had higher cash tax savings compared with those firms that were headed by managers without such past experiences. Kubick and Lockhart (2017) found that the factor of the CEO’s overconfidence affects their corporate tax policy. An overconfident CEO may underestimate the likelihood that his firm will be audited for its tax position and will tend to engage in more aggressive tax planning. Gaertner (2014) investigated the association between CEOs’ remuneration packages and corporate tax avoidance. He argued that there is a positive correlation between the post-tax incentives and the corporate ETRs, which is consistent with the economic theory concerning the use of post-tax incentives for executives. Meanwhile, Olsen and Stakelberg (2015) studied a personality trait of executives, narcissism, and its association with corporate tax sheltering. They found that, similar to the study conducted by Kubick and Lockhart (2017), the CEOs’ narcissism influences the likelihood that their firms will engage in corporate tax sheltering activities.

**Social norms**

Social norms can be viewed as the standard of morality that orients a particular group. Wenzel (2005) argued that the factor of social norms does affect tax compliance and vice versa. The study undertaken by Bobek, Roberts and Sweeney (2007) and Traxler (2010) supported Wenzel’s (2005) findings that social norms are significant in explaining compliance behaviour. Moreover, Cialdini, Reno and Kallgren (1990) found that there was a tendency for an individual to imitate the behaviour of others based on the perception of what is acceptable. The factor of social norms such as ethics and
cultural values also affects the compliance of the individual in a complex way (Bobek, Hageman & Kelliher, 2013). For example, a survey study conducted by Cummings, Martinez-Vazquez, McKee and Torgler (2009) in Botswana and South Africa provided evidence that compliance behaviour is also affected by the social norms and by the responsiveness of their government to listen to their people's aspirations.

One feature of social norms that directly affects corporate compliance is the corporation's reputation. Several studies indicate that most corporations are concerned about maintaining their impeccable reputation (Cooper, 1994; Oats & Tuck, 2008; Toumi, 2009; Mulligan & Oats, 2009). Hanlon & Slemrod (2009) explained that when news about the harmful conduct of a firm, such as its engagement in tax shelters, is made public, then the firm's stocks price may subsequently decline. Hence, when a company comes under the spotlight for corporate non-compliance either through public scrutiny or legal action, then its reputation is at stake (Williams, 2007). Graham, Hanlon, Shevlin and Shroff (2013) argued that the company's reputation is a significant factor for managers when applying the correct tax planning strategy as reputational cost is at stake. Erle (2008) added that by maintaining a good reputation, managers believe that they have acted in accordance with the interest of the shareholders. Lavermicocca (2011) argued that there was a consensus among large corporations that non-compliant behaviour negatively impacts on reputation; therefore the reputational cost is suggested as a critical factor that may curtail the tax avoidance efforts of corporations (Gallemore, Maydew & Thornock, 2014) since the effect of reputational damage on a corporation is much more pronounced than that on the individual (Ford, 2005).

**Fairness**

The study of Kirchler, Hoelzl and Wahl (2008) indicated that the issue of fairness is perceived as the most critical factor determining individual taxpayer compliance. Taxpayers are more inclined to comply when they perceive that the tax system is fair (Slemrod, 2007; Schweitzer & Gibson, 2008). Several aspects of fairness are considered as vital determinants of compliance. These are: (i) Distributive justice: the feeling that society does not have a just allocation of goods when compared with the tax that one must pay (Wenzel, 2002; Verboon & Van Dijke, 2007); (ii) Retributive justice: the
perception that the tax authority imposes the appropriate penalties for rules-breaking (Wenzel, 2002; Walsh, 2012); (iii) Procedural justice: the perceived fairness of the procedures and the treatment received from the authority (Wenzel, 2002; Murphy, Tyler & Curtis, 2009); (iv) Horizontal equity: equal treatment for taxpayer relative to other taxpayers in similar circumstances (Goetz, 1978; Kinsey & Grasmick, 1993); and, (v) Vertical equity: the fairness of the burden of taxes for certain social strata relative to other strata (Kinsey & Grasmick, 1993; Wenzel, 2002). An empirical study conducted by Murphy (2004a) of 6,000 Australian taxpayers showed that, in general, taxpayers would be less inclined to commit an infringement if they perceived that the tax system was fairer. Posner (2000) argued that tax compliance has a positive association with the perception of the fairness of tax systems in terms of appropriate tax policy, reasonable tax rates and unprejudiced enforcement.

The OECD (2004) argued that the factor of unfairness in a tax system may create an increased risk of non-compliance among taxpayers. As Mello (2009) stated, a tax system ideally should be neutral, fair, and should accommodate the interests of both the taxpayers and the tax authority. If the tax system regulations are perceived as unfair, this would undermine the taxpayers’ compliance with the law (Sunshine & Tyler, 2013). This is particularly relevant for developing countries situation where the fairness of the law and the regulations is considered to be far from ideal. Moreover, the low level of trust in the tax authority and the inconsistency in the application of the law are two significant problems that result in low compliance (Mascagni, Moore & McCluskey, 2014). Therefore, when the tax system is perceived as fair, the taxpayers are more inclined to comply with the rules.

**Trust**

Empirical evidence shows that the factor of trust in the authority and the government, has a considerable effect on tax compliance (See for example, Torgler, 2003; Torgler, 2008; Alm et al., 2006; Kirchler et al., 2008; Bird, 2008; Cheema, 2010; Blind 2010). Taylor (2002) argued that the taxpayer’s willingness to pay taxes was influenced by the level of trust in government. Further, Bird (2008) asserted that the trust between the taxpayer and the government not only establishes a sound tax system but also becomes a dynamic interaction which means that an increase in trust may increase
legitimacy and lead to a greater inclination to comply. Conversely, low trust in the government and the tax authority results in a higher level of tax evasion (Richardson, 2008; Kirchler et al., 2008).

Trust in the government is affected by several factors. Van der Hel-van Dijk and Siglé, (2015) argued that government activities such as the efficiency and efficacy of politicians and the political structure factor such as direct versus indirect democracy influence the government legitimacy. Meanwhile, it is worth noting that factors such as corruption and unfair treatment may decrease legitimacy. In terms of corruption, past studies have found that the corruption of State officials has a negative impact on taxpayers’ compliance (Flatters & Macleod, 1995; Picur & Riahi-Belkaoui, 2006; Bird et al., 2008; McKerchar & Evans 2009; Bird & de Jantscher, 1992; Rosid, Evans & Tran-Nam, 2016). Also, the feeling of having been mistreated by the tax authority also has a negative impact on compliance (Slemrod, 1992; Wenzel, 2002; Murphy, 2004b; Slemrod, 2007; Schweitzer & Gibson, 2008). Hence, Kogler, Bartranea, Nichita, Pantya, Belianin, & Kirchler (2013) suggested that the government needs to cultivate the taxpayers’ trust by providing better treatment and procedural fairness with the objective of achieving better voluntary compliance. The World Bank confirmed that the public does not trust a tax authority if taxpayer issues are not resolved, and this may undermine the government’s legitimacy in collecting taxes (Guerrero, 2011).

3.3.3 Corporate Characteristics

Several empirical studies demonstrated that corporate characteristics do influence corporate tax compliance (See for example Hanlon et al., 2005; Chen & Chu, 2005; Slemrod, 2007; Lanis & Richardson, 2011; Taylor & Richardson, 2013; Richardson, Taylor & Lanis, 2013). Firms have several characteristics that influence tax compliance. Factors such as the composition of the Board of Directors (BOD), tax risk management, the use of tax advisors, business profitability and ownership are considered the major corporate characteristics (van der Hel-van Dijk-van Dijk, & Siglé, 2015). It is worth noting that the degree of importance of each factor is not the same for every corporation and factors interact dynamically and can be interrelated in influencing the corporate compliance behaviour (Lavermicocca & McKerchar, 2013).
Tax risk management

Chen and Chu (2005) asserted that a firm with robust internal control tended to have a lower tax aggressiveness. The quality of tax risk management (TRM) as an element of a company’s internal control plays a part in determining the corporate compliance since not all tax decisions in a large business are made by those who are responsible; hence, a ‘tax control framework’ affects compliance (van Dijk & Siglé, 2015). Lavermicocca (2009) argued that TRM is not only about minimising tax risk; rather, it also concerns the level of tax risk that is accepted by a firm while at the same time ensuring that the right processes and procedures are taken into account. Further, the empirical study of Lavermicocca and McKerchar (2013) showed that there are several positive impacts of TRM operationalisation in a business. It: (i) reduces the level of tax risk, (ii) provides more informed tax decision making, (iii) lowers the tax risk profile, (iv) identifies potential non-compliance, (v) identifies opportunities to minimise income tax, (vi) acts on issues identified and, (vii) places greater importance on income tax compliance. It is worth noting that the effectiveness of a TRM system is determined mostly by its ability to enhance the information flow within a company. It needs to be highlighted that the application of TRM does not eliminate the tax risks faced by a company since there are several external factors that are beyond the control of a company. Nevertheless, the existence of a TRM in a company makes the management aware of the potential risks. Therefore, the implementation of a comprehensive and successful TRM system results in more informed decision-making and establishes good governance practices in a business (Lavermicocca & McKerchar, 2013).

As part of the corporate governance system, Erle (2008) argued that the role of TRM has become more important as the tax authorities in many countries have tended to tighten their tax laws and regulations, and they give credit to the corporate taxpayers who have applied strong internal control. The short-term view taken by managers that tax is merely a cost factor needs to be reoriented to a long-term perspective by taking into consideration factors such as company reputation. Further, Erle argued that a balance between maintaining the reputation and strategically minimising ETR is vital for a company’s sustainability as it will result in the company’s annual report and the general public will later appreciate the management’s efforts. Conversely, the
management’s failure to identify significant tax risks and to develop appropriate tax measures may cost the company far more than money. Therefore, as remarked by Lavermicocca (2009), the recognition of TRM as a component of good corporate governance signifies changes in the culture and attitude of not only the management toward tax function but also the stakeholders in a large business.

**Composition of the Board of directors**

Lanis and Richardson (2011) conducted a study of the effect of Board of Directors (BOD) on corporate tax aggressiveness in Australia. They analysed a sample of 32 corporations, categorising them according to their level of tax aggressiveness. Sixteen corporations were categorised as tax-aggressive, and the remainder were considered non-tax-aggressive. The study found that the likelihood of being tax-aggressive can be reduced by having more independent BOD members in the organisational structure. This result was later confirmed with cross-sectional data of 401 corporations using the ordinary least squares regression method. The researchers concluded that the composition of the BOD might have an impact on tax aggressiveness; thus, a greater number of independent BOD members appears to deter tax aggressiveness as a result of better corporate governance. Minnick and Noga (2010) conducted a study using a sample of 456 S&P companies covering the period 1996 to 2005, to determine the influence of corporate governance on tax management and its performance in the long run. They found that a more independent BOD composition tends to focus more on foreign tax management and, in contrast, the larger size BOD tends to focus more on domestic tax management.

Another empirical study conducted by Zemzem and Ftouhi (2013) of 73 French public companies for the period from 2006 to 2010 was intended to determine the variables that can reduce tax aggressiveness. They found that the BOD size factor and, interestingly, the proportion of women on the board affect the company’s level of tax aggressiveness. A similar finding emerged from the study conducted by Lanis, Richardson and Taylor (2017) with a sample of 418 United States firms covering the period of 2006-2009. Their study indicated that female representation in the BOD has a negative association with the tax aggressiveness activities. This is consistent with the finding of several past studies that the factor of gender is an essential determinant of
compliance behaviour (See, for example, Hasseldine, 1999; Wartick & Rupert, 2010; Kastlunger, Dressler, Kirchler, Mittone & Voracek, 2010).

Ownership

The corporation’s ownership to some extent influences corporate tax compliance. Past studies usually focus on ownership characteristics - whether they are publicly listed, foreign-owned, hedge fund or family ownership (Hanlon et al., 2005; Slemrod, 2007; Chen et al., 2010; McGuire, Omer & Wang, 2012; Badertscher, Katz & Rego, 2013). The empirical study by Hanlon et al. (2005) in the United States using Internal Revenue Service (IRS) audit data found that companies with annual bonus packages and transnational corporations had a higher deficiency in the ETR. In mathematical terms, their calculation showed that the tax gap between the supposed liability and the real taxes paid by large corporations was 13 percent lower from 1983 to 1998, indicating transnational corporations adopted more aggressive tax policy. Hence, they concluded that non-compliance is related to the observable characteristics of a company such as the nature of the ownership. Compared to the public firm, the private firm is associated with higher non-compliance as it is less affected by the obligation to report its earnings publicly. Another study by Slemrod (2007) indicated that the large business with assets greater than USD five billion has the largest percentage gap of ETR deficiency, being 74 percent. Moreover, this study also showed that on average, the private companies have the highest deficiency rates at 17.1 percent compared to the listed companies at 12.5 percent.

In terms of ownership structure, Desai et al. (2005) argued that the tax policy can have significant implications for shaping ownership concentration, whereby a greater concentration can lead to a greater incentive to engage in tax avoidance (Desai & Dhamapala, 2008). The family firm in Italy which was examined in the Mafrolla and D’Amico (2016) study, is an example of concentrated ownership, and may be more or less tax aggressive depending on how entrenched the family is in the proportion of ownership and the management. They claimed that the controlling family could affect the earning capacity by opportunistically managing the firm’s financial reporting. In contrast, Chen et al. (2010) argued that the family firm in the US has lower tax aggressiveness since the owner is more concerned with the potential non-tax cost such
as reputational damage cost, potential penalties from the tax authority and resulted in the subsequent drop in the value of shares. Moreover, family firm run by its founders or non-professional managers in the US is less likely to use tax shelters. However, it should be noted as abovementioned that family entrenchment may have different consequences in different countries although, generally, the highly concentrated family firm is more likely to resemble the individual in its behaviour (Hanlon & Heitzman, 2010).

**Tax advisors**

The use of tax advisors by a firm can have different effects on corporate compliance (Klepper & Nagin, 1989). Tax advisors may help the company to exploit the ambiguous features of the law or alternatively, may encourage the firm to fully obey the law by enforcing the law's unambiguous features and by discouraging the reporting of a tax position that is likely to be challenged by the authorities.

Spilker, Worsham Jr. and Prawitt, (1999) conducted an experiment with 63 tax advisors comprising people with different positions and levels in the US to examine the attitude of tax professionals toward ambiguities in the tax law. They found that tax advisors would be likely to interpret ambiguity to the benefit of their client ranging from advising aggressiveness in terms of compliance but conservativeness in the context of tax planning with the caveat that the efforts were made to achieve client-preferred outcomes. In the same vein, Tan (2011) noted that tax advisors appeared to be afraid of losing their clients if they were unable to meet their clients’ demands by exploiting the ambiguity of the tax law. She further argued that tax advisors are sensitive to their client’s risk propensity and larger tax advisor firm tend to have larger corporations as clients which generally means that they have more complex transactions. Wurth and Braithwaite (2016, p.13) supported these studies and concluded that “tax practitioners in the aggressive group were distinguished by an increased propensity to compromise their preparation ethics and exploit the opportunity afforded by ambiguity within their clients; tax affairs”.

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Profitability

Some empirical studies reported the negative association between a firm’s profitability and its corporate tax compliance (see for example Rego, 2003; Mutti & Grubert, 2009; Richardson et al., 2013). Rego (2003) investigated whether more profitable firms in the US avoid more taxes that result in lower ETR. She found that the firms with higher pre-tax income had lower ETR and the MNC with extensive foreign operations, in general, have lower ETR than the US domestic firms. Therefore, the more profitable firms in the US are likely to engage in particular schemes or transactions to avoid taxes. Richardson et al. (2013) examined the major determinants of transfer pricing aggressiveness with a sample of 183 Australian publicly listed firms. They found that profitability is positively associated with transfer pricing aggressiveness. In addition, the highly profitable corporations are not only able to locate their expenses in a high-tax jurisdiction, but are also able to arrange their profits in a low tax jurisdiction. For example, Microsoft transferred royalty payments from a country with a high tax rate to Ireland that has a low corporate income tax rate (Mutti & Grubert, 2009).

Several studies also reported that corporations which are under pressure from profitability issues and financial constraints tend to be more tax aggressive (Edwards, Schwab, & Shevlin, 2016; Law & Mills, 2015; Dyreng & Markle, 2016; Akamah, Omer & Shu, 2016). When there are financial constraints, the managers focus more on generating additional operating cash flows, and they are reducing their expectation in terms of current earnings. One way to generate the additional cash flow is by increasing tax savings through more aggressive tax planning schemes utilising deferred-based strategies (Edwards et al., 2016). The firms under financial constraints are also utilising more foreign operation in tax haven location while in the meantime they reported higher unrecognised tax benefit with the objective to lower the ETR (Law & Mills, 2015). Meanwhile, Dyreng and Markle (2016) found that the US MNCs are engaged in income shifting in a systematic way following tax incentives policy, and the financially constrained firms shift less income to their overseas affiliations compared to their unconstrained counterparts. Moreover, Richardson et al. (2014) argued that the financial distress situation as the result of the global financial crisis or internal hardship has a positive association with more aggressive tax avoidance activities. Therefore, the financial constraints situation is likely to encourage the firms
to seek more tax savings, and they make a more concerted attempt to pursue more tax aggressiveness (Akamah et al. 2016).

3.4 The responsive regulation approach

In the past, taxpayer compliance has been sought by means of a ‘command-and-control’ approach (Braithwaite 2007, Leviner, 2009). The approach involves regulators applying direct enforcement measures to execute the law (Braithwaite, Murphy & Reinhart, 2005). With this mechanism, the regulators ‘command’ taxpayers to obey the law and ‘control’ their behaviour by using punishment as a threat to violators (Sinclair, 1997). This approach to regulation is equivalent to the work of criminal justice agencies that upon established laws that impose, “threatened penalties for non-compliance, and punishment for violators” (Job & Honaker, 2003, p.3).

Critics, however, have expressed their criticism that the approach of command and control has wrongly interpreted the meaning of non-compliance, and this flaw has resulted in inefficiency in practice. The approach does not recognise the nature of non-compliance, since the notion of a ‘one-stop pit’ for all misconduct seems ill-suited to the practical realities (Paternoster & Simpson, 1996; Aalders & Wilthagen, 1997; Vaughan, 1998).

Some argue that the law enforcers should be moving from command and control to a more naturally suited approach (Ayres & Braithwaite, 1992; Vaughan 1998; Sparrow, 2011). One alternative offered is to pursue taxpayer compliance through persuasion, education, encouragement and assistance (Braithwaite, 2003). This alternative approach that is termed ‘responsive regulation’ is considered as the soft approach. This approach recognises that to achieve compliance, it should be acknowledged that it is impossible to detect and enforce every contravention of the law. Moreover, it would be more effective to persuade taxpayers to comply voluntarily with tax law and to encourage self-regulation (Braithwaite, 2007). The responsive regulation arguably favours cooperation from the taxpayer and is aligned with the objective of regulators to stimulate an optimum level of regulatory compliance (Welsh, 2009). As noted by Braithwaite (2011, p.489), “the job of responsive regulators is to treat offenders as
worthy of trust because the evidence is that when they do this, regulation more often achieves its objectives”.

Also, this approach enables regulators to decide how misconduct should be handled - by using either a ‘stick’ or ‘carrot’ approach. ‘Stick’ is a symbol of punishment for those who fail to comply and, in contrast, ‘carrot’ represents a reward for those who follow the law. Regulators are advised to apply ‘stick’ or ‘carrot’ depending on the taxpayer situation or the people with whom they are dealing (Ayres & Braithwaite, 1992; Braithwaite, 2002; Andreoni, Harbaugh & Verlund, 2003).

The responsive regulation approach is based on the notion that regulators should be responsive to the conduct of taxpayer in deciding whether to escalate or de-escalate the intervention level of action (Ayres & Braithwaite, 1992). This theory assumes that the soft approach is more likely to encourage compliance. Braithwaite (2003) argues that persuasion, education, encouragement, and the assistance from the authority are the main instruments to enhance voluntary compliance. In particular, the regulator should be responsive to the way taxpayer regulate themselves before the regulator decides to either persuade or punish (Braithwaite, 2002). In this context, the law enforcer frames the aspiration that the tax office is trusting taxpayers. The argument is that taxpayers will regard stronger enforcement as fair and procedural if they have been persuaded. The application of persuasion as the frontline measure and punishment as a fallback would arguably minimise the undesirable consequences of this deterrence measure if it backfires (Makkai & Braithwaite, 1994). As noted by Nielsen and Parker (2009, p.382), law enforcers are encouraged to be “fair, open-minded, respectful, not stigmatising, persuasive and cooperative”. In all, Braithwaite (2011) summarised the principles of responsive regulation as shown in Figure 3-1 below.
1. Think in context; don’t impose a preconceived theory.
2. Listen actively; structure dialogue that:
   - Gives voice to stakeholders
   - Settles agreed outcomes and how to monitor them;
   - Builds commitments by helping actors find their own motivation to improve;
   - Communicates firm resolve to stick with a problem until it is fixed.
3. Engage those who resist with fairness; show them respect by construing their resistance as an opportunity to learn how to improve regulatory design.
4. Praise those who show commitment:
   - Support their innovation
   - Nurture motivation to continuously improve;
   - Help leaders pull laggards up through new ceilings of excellence.
5. Signal that you prefer to achieve outcomes by support and education to build capacity.
6. Signal, but do not threaten, a range of sanctions to which you can escalate; signal that the ultimate sanctions are formidable and are used when necessary, though only as a last resort.
7. Network pyramidal governance by engaging wider networks of partners as you move up a pyramid.
8. Elicit active responsibility, (responsibility for making outcomes better in the future), resorting to passive responsibility (holding actors responsible for past actions) when active responsibility

**FIGURE 3-1 NINE PRINCIPLES OF RESPONSIVE REGULATION**

Source: (Braithwaite, 2011, p.476)

To indicate the responsiveness to persuasion or punishment, Ayres and Braithwaite (1992) developed a regulatory pyramid. The basic assumption underlying this pyramid is that enforcement strategies are driven by hierarchical order. The base of the pyramid is the widest area represents where the most regulatory action was taken: persuasion or dialogue. Regulators move up to the next level when the persuasion measure alone does not work. The enforcement escalation process continues to the upper level if the simple forms of punishment fail on the base level and as a consequence, the full enforcement is applied at the apex of the pyramid.
The adjustment of the standard regulatory pyramid for tax administration purposes is illustrated in Figure 3-2. The ATO adopted a policy to handle taxpayer's compliance based on responsive regulation approach concerning taxpayers' responses. For example, the base of the pyramid is the most desirable area for the operations of business and the tax administration. At this level, tax administration applies the approach by educating taxpayers and encouraging voluntary compliance through cooperation and self-regulation. At the middle level, taxpayers are persuaded to be self-regulated with the assistance of tax officials. Moreover, the full, active enforcement is applied when the previous measures fail as shown at the top of the pyramid. The diagram also shows that flexibilities apply during the movement both up and down the pyramid from the self-regulation and cooperation to the active enforcement depending on taxpayers' responses (ATO, 2000).

3.5 Compliance risk management (CRM)

The European Commission (2006, p.5) defined the compliance risk management for tax administration purposes as:
a systematic process in which a tax administration makes deliberate choices on which treatment instruments could be used to effectively stimulate compliance and prevent non-compliance, based on the knowledge of all (taxpayers’ behaviour) and related to the available capacity.

The European Commission (2006, p.6) stated further that “risk analysis also involves the why question: why is the taxpayer behaving in a particular fashion. Taxpayer behaviour is critical because it contributes to the assessment and the choice of the most efficient and effective form of treatment”. However, the OECD (2004, p.8) prefers a more practical concept where compliance risk management is perceived as “structured process for the systematic identification, assessment, ranking and treatment of tax compliance risks”.

The CRM definition established by the European Commission was based on the responsive regulation principle (as shown in Figure 3-2) where the tax administration should be responsible for the conduct of taxpayers, encourage taxpayers to self-regulation by utilising instruments that effectively stimulate compliance before intervening action is taken (Ayres & Braithwaite, 1992). As Sparrow (2011) noted, the regulator should conduct any interaction with the taxpayer in a responsive, respectful and professional manner.

![Diagram of CRM processes](image)

**FIGURE 3-3 THE CRM PROCESSES**

Source: Adapted from OECD (2010, p.9)
Subsequently, the OECD (2004) framed the way that the process of compliance risk management should occur at each stage of a sequence of actions (as shown in Figure 3-3). The stages are: risk identification, risk assessment and risk prioritisation, compliance behaviour analysis, determining the strategy to be applied, and the planning and implementation. These five stages of the compliance risk management process have been promoted by the OECD and the European Commission as practical guidelines for tax administration to manage compliance risks systematically.

This first stage is a significant step because if the risks are not identified, then they are unlikely to be addressed (EC, 2010). This step is needed to identify specific types of non-compliance behaviour that poses substantial compliance risks if left untreated, and the risk should be identified more specifically in order to provide proper treatment\(^{35}\). In general, the purpose of the risk identification is “to identify the specific compliance risks that a revenue authority must confront as comprehensively as possible, minimising the possibility of oversight, and facilitating the subsequent in-depth analysis” (EC, 2010, p.16). This step will produce a list of potential risks, and all risks will be comprehensively registered (OECD, 2004).

The second stage in the OECD framework involves assessing and prioritising compliance risks by quantifying previously identified risks. This step aims to separate the significant risks from the minor ones based on the consequences that are anticipated based on their impact upon the organisational objectives and the likelihood of the occurrence of the risks either qualitatively or quantitatively or both. Prioritisation is necessary because it is not possible to address all risks. The tax authority needs to balance the approach regarding significant risks that may affect the organisation’s achievement of its objective (OECD, 2004). Hence, the tax authority needs to consider not only the behaviour, attitude and culture of taxpayers, but also the internal environments of the tax administration (Black & Baldwin, 2010)\(^{36}\). This stage produces two outcomes: a quantified and prioritised register of risks and a

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\(^{35}\) For example, the risk of cash economy transactions should be mitigated by the detailed identification of specific group behaviour according to its community in which it is toned (OECD, 2004).

\(^{36}\) The CRM is an iterative process instead of a single process in facilitating better decision-making. Hence, it requires efforts of analysis, research, fact-finding and careful judgment (OECD, 2004).
documented compliance programme which needs to be undertaken based on the objective evidence (OECD, 2004).

In the third stage, the OECD (2004) suggests that an understanding of taxpayers’ behaviour is a significant issue with economic factors (financial burden, the cost of compliance, disincentives and incentives) and behavioural factors (individual differences, perceived inequity, perception of minimal risk and risk-taking) requiring identification and analysis by the tax administration. The understanding is aligned with the reasons for non-compliant behaviour as pointed out by Webley (2004) such as the perception of equity, the opportunity for non-compliance, individual differences, social norms and dissatisfaction with tax authorities. In short, this step includes compliance behaviour analysis. One of the advantages of applying CRM is that it produces a focus on the underlying drivers rather than only the symptoms which means there is no single measure that is appropriate for every problem (OECD, 2013). In this case, a sustained longer-term compliance outcome can be obtained by allowing the authority to recognise the ‘causes’ of specific non-compliance. Conversely, failure to recognise the causes of non-compliance can result in inappropriate treatment that not only aggravates the underlying issues but also may anger the community (Leviner, 2008).

In the fourth stage, determining appropriate treatment strategies means that the outlined compliance programs provide a different response to those who want to comply and apply stricter enforcement to those who do not (OECD, 2004). In this stage, treatment needs to be delivered with fairness and respect that will secure the taxpayers’ trust and encourage voluntary compliance (Feld & Frey, 2007). It has been recognised that inducing changes in taxpayer behaviour is not an exact science, but it is also not a matter of pure conjecture (OECD, 2010). Treatment strategies can be applied only if the recognised risks have been addressed and the causes of non-compliant behaviour have been identified (OECD, 2004). The tax administration is also advised to strengthen community partnerships by building strategic alliances with other institutions, industry bodies and tax advisers in order to obtain significant leverage in its compliance activities (OECD, 2004). Aside from the general strategy to encourage voluntary compliance, the tax authority also must have a range of tools to deal with non-compliance since it is impossible to apply only a single tax strategy.
These have to be applied appropriately according to the level of the risk as the tax authorities not only have finite resources but also have to anticipate dealings with various types of taxpayers. For example, Kornhauser (2008) suggested a shaming approach as a strategy for dealing with high-profile delinquent taxpayers by publicising their names and their tax arrears in the mass media. On the other hand, for taxpayers who manage non-compliance risks, OECD (2004) suggested the authorities give such taxpayers incentives such as promoting a withholding tax system as this system enables taxes to be collected at the same time as income is earned, or encouraging taxpayers to improve their bookkeeping as the audit trail records would prevent tax evasion and even money laundering.

For the final stage, the OECD (2004) argues that an effective application of these treatment strategies relies on three fundamental capabilities, namely, resources, design and execution. These procedures are applied in a way that demonstrates efficient use of resources, engages stakeholders in its implementation, and ensures effective execution. Another important step to be taken by the tax authority is the evaluation of the outcomes. The evaluation will measure the success of those implemented strategies and determine the effectiveness of the compliance programme. The OECD also advises the monitoring of performance and outcomes in terms of the planned objective. As iterative process, the CRM process could be seen as a continuous cycle.

3.6 Tax administration in developing countries and responsive regulation

Understanding the true nature of taxpayer behaviour and applying the right strategy such as CRM are suggested by both OECD (2004) and the European Commission (2010) as the means to improve taxpayer compliance. However, the guidelines issued by the OECD or the European Commission are formulated with developed countries in mind, and their circumstances are quite different from those of developing countries. Several studies have indicated various challenges faced by tax administration in developing countries, both internally and externally (Baurer, 2005; Baer & Silvani, 1997; Trasberg, 2004; Mascagni et al. 2014; Tanzi & Zee, 2000; Brautigam et al., 2008; Bird, 2008; McKerchar & Evans, 2009; Gordon & Li, 2009). For example, a limited organisational capacity, rampant corruption, a mounting cash
economy problem and a lagging behind in technology. Moreover, emerging issues such as the globalisation of commerce have caused additional problems for the tax administration in preventing tax evasion since business operations have become more global and with a more complex structure. All of these challenges are likely to result in lower enforcement capabilities (Baurer, 2005).

Surprisingly, many tax administrations in developing countries are still adopting the deterrence approach to prevent tax violations by spreading fears among taxpayers, which is arguably not a good means of ensuring voluntary compliance (Mahmood, 2012). Ayres and Braithwaite (1992, p.26) asserted that developing compliance through deterrence inevitably incurs high costs, consumes resources that a developing country lacks, stating that, “persuasion is cheap, and punishment is expensive”. Moreover, Braithwaite (2006) argued that adopting deterrence as an enforcement method is not suitable for a developing country as its execution is costly.

Furthermore, Braithwaite (2006) suggested that a developing economy with limited regulatory capacity may benefit from the use of responsive regulation. The application of a soft approach such as responsive regulation is considered more suitable (Ayres & Braithwaite, 1992). The application of a soft approach is not a complete substitute for the punishment approach. Instead, punishment as deterrence is used when the persuasion is failed in maintaining compliance. This is known as a ‘tit-for-tat’ strategy which posits that both persuasion and punishment are used alternately in fostering compliance and preventing non-compliance. The flexibility in responsive regulation allows tax administrations to prioritise enforcement strategies in the case of the high-risk flag. The advantage of this strategy is its cost efficiency as the resources of the organisation are appropriately allocated according to the pecking order of case management which prioritises cases with higher revenue potential (Braithwaite, 2007; Baldwin & Black, 2008).

However, due to its flexibility, responsive regulation is criticised for its enforcement consistency. The conservative measure or deterrence approach is considered to be more consistent because, theoretically, all offenders would be punished for their violation. Braithwaite et al. (2005) acknowledged this shortcoming and in reality, the enforcement flow perhaps does not always follow the rule of responsive regulation.
which systematically moves up or moves down level by level from the base pyramid to the top or vice versa. For example, compliance might be hard to achieve by means of dialogue or persuasion alone in the case of certain violators (Daly, 2003). Nielsen and Parker (2009) added that the expectation for the regulators to consistently behave as requested by tit-for-tat strategy is quite difficult, even when they are trying to act responsively.

Nevertheless, despite the criticism, Leviner (2009, p.381) claimed that “responsive regulation may, therefore, constitute a superior method for regulating tax compliance”. He argued that responsive regulation establishes a framework that integrates a balanced and forward-looking method for enforcement. This approach conceptualises behaviour not only as a product of the desires, needs and limits of self-directed taxpayers, but it also acknowledges that taxpayers are affected by environmental and personal factors such as values, norms, habits and their interaction with the authorities. By emphasising that the interaction plays a significant role in moulding taxpayer behaviour, the tax authority is empowered to live up to its own responsibilities and might be able to explore various ways to manage the relationship. The point here is not only to enforce compliance when it is poor, but also to strengthen and manage the current compliance efficiently and fairly with the aim of improving voluntary compliance. Given the ever-changing tax laws, the improvement of voluntary reporting has become more critical. Further, the enforcement policy might be more effective if the authority encourages self-regulation through persuasion, assistance and education, while punitive enforcement should be applied only when necessary. That is where responsive regulation asserts its superiority as an enforcement strategy as it applies penalties in a gradual and proportionate manner. Responsive regulation represents a shift from rigid deterrence to a dynamic framework that encompasses the interplay of tax authority-taxpayer interaction. It no longer applies a particular formula to achieve optimal deterrence, but instead has realised the optimal way to play the ‘enforcement game’ (Ayres & Braithwaite, 1992).
3.7 Corporate tax compliance studies in Indonesia and knowledge gap

To date, few studies have investigated the tax compliance behaviour of Indonesian large business. The researcher has documented several general corporate compliance studies in Indonesia that do not deal specifically with corporate tax behaviour, but whose titles indicate the research direction. These are presented in Table 3-2 below.

<table>
<thead>
<tr>
<th>No.</th>
<th>Author</th>
<th>Year</th>
<th>Title</th>
<th>Research Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.</td>
<td>Sitardja, M., &amp; Dwimulyani, S.</td>
<td>2016</td>
<td>Analysis About the Influences of Good Public Governance, Trust Toward Tax Compliance on Public Companies that Listed in Indonesian Stock Exchange</td>
<td>Quantitative</td>
</tr>
<tr>
<td>7.</td>
<td>Harinurdin, E.</td>
<td>2009</td>
<td>Corporate tax compliance behaviour*</td>
<td>Quantitative</td>
</tr>
<tr>
<td>8.</td>
<td>Rahayu, N</td>
<td>2013</td>
<td>Tax avoidance practices by foreign direct investment limited companies*</td>
<td>Mixed method</td>
</tr>
</tbody>
</table>

Note: * in the Indonesian language

Hartadinata and Shauki (2013) conducted a quantitative study to examine the effect of income tax rates changes on the tax payment compliance. They used 222 Indonesian listed companies as the sample covering the 2008-2010 period, using ordinary least square and logistic regression for data analysis. They found that the decrease in income tax rates has driven lower tax aggressiveness and the increase of debt financing has a negative association with tax aggressiveness. They also found that the changes in corporate characteristics such as managerial ownership, audit quality and corporate governance do not have a significant influence on tax aggressiveness.
Sari and Martani (2010) compared the tax aggressiveness of family-ownership companies with that of corporate governance. They used 40 listed manufacturing firms covering the 2005-2008 period and analysed the data using analysis of variance (ANOVA). They showed that corporate governance has a negative association with tax aggressiveness, while family-owned firms in Indonesia tend to be more tax aggressive than the non-family firms. Sari and Tjen (2017) conducted a study with a sample of 188 non-financial firms that were listed on the Jakarta stock exchange from 2009 to 2012. They examined the relationship between corporate tax aggressiveness and the corporations’ social responsibility (CSR) and environmental activities. Their study found that the firms with active CSR and environmental activities tend to be less tax aggressive. Sitardja and Dwimulyani (2016) examined 87 non-financial listed companies in order to determine the relationship between good public governance and tax compliance. Their study showed that the three aspects of good public governance which are tax fairness, tax reputation and tax transparency, have a positive association with taxpayer compliance.

Susila and Pope (2012) calculated tax compliance costs of large businesses in Indonesia for 2010. They found that the gross compliance costs were estimated at 3.16 percent of total tax revenue collected from those large businesses in the year of interest. Mulyani’s (2010) study examined the factors that influence transfer pricing compliance. She found that some determinants affecting tax compliance are the probability of audit, and that penalties have a positive association with the compliance, while the perception of corruption and tax rate have a negative association with compliance.

Harinurdin (2009) examined the behaviour of large businesses that were registered with the Large Tax Office, DGT in 2008. He analysed the data using Structural Equation Modelling to investigate the correlation between tax compliance and predetermined indicator variables. His study found that the variables that significantly influence taxpayer behaviour are: detection probability, profitability, corporate climate and the use of tax advisor. The result of Rahayu (2013)’s study indicated that three schemes tend to be used by foreign investment companies in Indonesia to avoid tax; these are transfer pricing, thin capitalisation and treaty shopping.
The abovementioned studies provide useful information about the corporate tax compliance situation in a developing country. However, only two studies have focused on large business in Indonesia; these were conducted by Harinurdin (2009) and Susila and Pope (2013). Both studies employed the quantitative method to analyse data with predetermined variables to obtain the results. It is worth noting, however, large business tax compliance is a major issue in tax research because of its economic importance (van der Hel-van Dijk-van Dijk & Siglé, 2015) especially in developing countries, considering the contribution made by corporate tax revenue to the total State revenue (Arnold, 2008). The determinants that shape large business compliance especially in developing countries are, unfortunately, rarely fully explained in the body of literature.

The area of corporate tax research, in general, is an area of tax study that has been flourishing in recent years. Feller and Schanz (2014) calculated that the pace of corporate tax research alone had outperformed other tax research area by more than six-fold in the period 2004 to 2013 compared to the preceding decade or from 1994 to 2003. Tax compliance as a complex social phenomenon has attracted the interest of scholars from various disciplines such as law, politics, economics, accounting, history and psychology (Oats, 2012; McKerchar, 2008). Both researchers and policymakers alike have a deep interest in discovering more about the true nature of the corporate sectors’ motivation to pay taxes. However, as stated by Hanlon and Heitzman (2010, p.168), “Has tax research progressed since Shackelford and Shevlin (2001)? Undoubtedly, it has. Although the effects of taxes on ‘real’ corporate decisions are at times difficult to document, they are important to examine.” Therefore, any study conducted to improve corporate tax compliance is more than welcome. Furthermore, the study of corporate tax compliance becomes more relevant as the government attempts to reduce the tax gap, improve compliance and collect more revenue (Hanlon & Heitzman, 2010). Then, this omnipresent phenomenon of companies and taxes generates an important question: What motivates companies to pay taxes?

The literature does not answer this question adequately. Feller and Schanz (2014) observed that tax research is currently dominated by quantitative empirical research, which to some extent leaves many puzzles and conflicting evidence to be reconciled. For example, there is no consensus among researchers regarding the factors that
impact the most on taxpayers’ compliance (McKerchar & Evans 2009). Hence, it is argued that a more in-depth understanding of the true motivation of companies to pay taxes and the factors that make them pay is still lacking in the current discussions. Considering the state of current research, it is reasonable to conduct a study that would be beneficial and highly relevant in revealing the factors that motivate companies to pay their taxes since taxation is part of a social phenomenon (McKerchar, 2008). As stated by Boden, Killian, Mulligan and Oats (2010, p.543), “critical analyses of tax as a social phenomenon of considerable significance to scholars”.

Hence, this study was designed to fill the gap in tax compliance studies, particularly in the area of corporate tax compliance in a developing country, which is rarely addressed in the body of literature. This, therefore leads to the aim and the research problem of this study:

What are the factors that influence large businesses tax compliance risks from the perspectives of the tax officials, the tax managers, and the independent tax advisors?

---- and ----

How does the tax authority manage large business taxpayers’ compliance risks according to the factors identified by addressing the previous research question?

The factors that influence large businesses tax compliance risks and the way that the tax authority manages such risks are chosen as the core of this study for the following reasons.

First, to the best of the researcher’s knowledge, research studies have yet to investigate in depth the factors that influence large businesses’ tax compliance risks particularly in a developing economy and taking into account the perspectives of the direct actors in the field. Therefore, being a largely unexplored area, this theme warrants further study. It is apparent that as a social phenomenon, the companies’ motives either to comply or not to comply have captured the interest of numerous scholars, and the subject has been discussed from many angles. However, there is no evidence in the body of literature that and study has explicitly investigated the factors that influence
large businesses’ tax compliance in a developing country and from the perspective of those directly involved in the process.

Second, the documentation on how a tax authority in a developing country manages the issue of large business tax compliance risks, to the best of the researcher's knowledge, is rarely discussed in the literature. Most of the literature on tax authorities’ experiences in managing large businesses’ compliance concerns the developed countries. This is despite the fact that corporate tax revenue is more critical for developing countries as it contributes a significant proportion of their total revenue and these nations have limited ability to collect more revenue from other types of taxation. Therefore, the exploration of an uncharted area of corporate tax compliance where the sources of data are the key informants is of great significance as previous studies have rarely included the tax officials’ perspectives in the discussion.

Finally, although some studies have identified compliance determinants for large corporate taxpayers, the true nature of corporate decisions that are affected by taxes is not fully understood. There is no evidence that past studies have investigated systematically the perspectives of inter-related actors that shape the compliance of large corporate taxpayers in a developing country. Hence, a rigorous study of economic and behavioural factors is necessary to reveal the real issues faced by both taxpayers and tax authorities and to improve the quality of existing theories. Nevertheless, this study was unable to capture all determinants that influence compliance. Instead, firstly, it relied on information from the data sources to reveal the actual factors that are perceived as influencing compliance as these are corroborated by the findings of previous studies. Secondly, the methods used by tax authorities to manage compliance risks have been investigated to provide readers with a comprehensive picture of the real situation regarding the enforcement of compliance. Finally, responsive regulation theory, as the current best practice in managing tax compliance, has been examined to determine its suitability for a developing country.

37 See for example: Benon, Baer and Toro (2002); OECD (2009); EC (2010).
38 Developing countries are more susceptible to the large business tax avoidance activities as they rely heavily on corporate taxes as their main revenue source compared to the developed ones where the proportion of tax revenue is relatively more balanced (Dharmapala, 2014).
Hence, it is reasonable to conclude that a qualitative approach is arguably the most appropriate as this study seeks an in-depth understanding of large businesses tax compliance behaviour as a social phenomenon. A detailed discussion of the adopted research design and methodology is presented in the next chapter.

3.8 Chapter summary

This chapter reviewed the major concepts and the literature related to the research problem. It begins with an overview of the concepts of tax compliance, tax avoidance and tax risk. It was found that tax compliance, tax avoidance and tax risk are fluid concepts that have various meanings depending on the perspectives encompassing various aspects. It was concluded that tax compliance definitions could be divided into two categories which are the conceptual definition and the practical one. Regarding tax avoidance, it was found that there is no consensus among scholars for the boundary of tax avoidance; however, in terms of tax evasion, this study adopted the OECD definition of tax evasion as referring to any illegal arrangements. The revenue loss caused by tax avoidance practices is also more pronounced in developing countries which, as a result, suffer the most harm. The term ‘tax risk’ has a meaning for the authority that differs from that of the taxpayers even though both parties need to manage the risks appropriately with respect to their own objectives.

Factors influencing corporate compliance can be categorised into three major groups, namely, economic factors, socio-psychological factors and corporate characteristics. The elements of these major groups are further discussed. The group of economic factors consist of penalties, detection probability, tax rate, manager compensation, risk appetite, complexity of the law, and uncertainty. The group of socio-psychological factors comprises personal and social norms, fairness and trust, while the group of corporate characteristics consists of BOD’s composition, tax risk management, ownership, the use of tax advisors, and profitability.

The concept of responsive regulation and the CRM are reviewed in Section 3.4 and 3.5, respectively. It was concluded from Section 3.4 that mostly tax compliance could be encouraged by taking the soft-approach involving persuasion, education, encouragement and the assistance from tax office as the main instruments rather than relying on mere deterrence. The OECD and the European Commission suggest that a
CRM be established based on the responsive regulation concept as a practical guide to assist tax administrations to manage their compliance risks systematically. The tax administration in developing countries is discussed in Section 3.6, together with the possibility of adopting a responsive regulation approach.

Finally, Section 3.7 discussed the studies on corporate compliance in Indonesia, followed by the identification of the knowledge gaps in the literature and the context of this study. Further research is needed to explain the phenomenon of corporate tax compliance in a developing country.

Chapter 4 explains the choice of research design and includes methodology, theory, the domain, and research method. The chapter also discusses the data collection and analysis process, and the issue of reliability and validity of the study.
CHAPTER 4
RESEARCH DESIGN AND METHODOLOGY

4.1 Introduction

This chapter provides a discussion of the research design and methodology employed in this study in order to achieve the research objectives. This chapter is organised into five main sections. Section 4.2 addresses the research questions and section 4.3 presents a justification of the research design with four subsections of methodology, theory, domain and research method. Section 4.4 describes the process used for the data collection (interviews) and for the data analysis. Section 4.5 discusses the issues of reliability and validity, and section 4.6 concludes the chapter.

4.2 Research questions

This research examines the factors contributing to the income tax compliance of large business in Indonesia and how the tax authority responds to such issues. Specifically, it addresses two research questions under one integrated study. The details regarding the selection of research questions, the research objectives, the background and the motivation for conducting this study are presented in Chapter 1. The two research questions are re-stated here as they determine the selection of an appropriate research methodology.

**Research Question One**: What are the factors that influence large business taxpayers’ compliance risks from the perspectives of the tax officials, the tax managers, and the independent tax advisers?

**Research Question Two**: How does the tax authority manage large business taxpayers’ compliance risks according to the factors identified by addressing the previous research question?
4.3 Research design

In order to choose a suitable method and to guide the research, it is useful to apply four fundamental research concepts suggested by Ahrens and Chapman (2006). These concepts, and their application in this study, are summarised in Table 4-1 below. A more detailed discussion of our approach is presented in subsections 4.3.1 to 4.3.4.

<table>
<thead>
<tr>
<th>No.</th>
<th>Concept</th>
<th>Description</th>
<th>Applied to this study</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Methodology</td>
<td>General approach to research</td>
<td>Qualitative interpretative</td>
</tr>
<tr>
<td>2.</td>
<td>Theory</td>
<td>The explanatory concept</td>
<td>Tax compliance literature, responsive regulation</td>
</tr>
<tr>
<td>3.</td>
<td>Domain</td>
<td>Space in which data is collected</td>
<td>The field of large businesses, tax office and tax advisors</td>
</tr>
<tr>
<td>4.</td>
<td>Research Method</td>
<td>Specific research technique</td>
<td>Semi-structured interviews</td>
</tr>
</tbody>
</table>

Source: Adapted from Ahrens and Chapman (2006, p.821)

4.3.1 Methodology

This study attempts to answer the call for tax research in the area of corporate tax compliance. As stated by Hanlon and Heitzman (2010, p.168),

Has tax research progressed since Shackelford and Shevlin (2001)? Undoubtedly, it has. Although the effects of taxes on 'real' corporate decisions are at times difficult to document, they are important to examine... The relevance of tax avoidance research will increase as governments try to close the tax gap, increase compliance, and collect more revenue.

Therefore, any research related to the area of corporate tax compliance will be welcomed in the literature regardless of the research method employed. As noted by Shevlin (1999, p.427), “… all methodologies can be found in tax research: namely, experimental markets, behavioural/judgement and decision making, analytical, and archival empirical”. Hence, the tax researcher may have a background comprising one or more different academic disciplines, each having a different research method since interdisciplinary knowledge in taxation research has been well recognised. For the
purposes of this study, a qualitative approach is adopted for the research. The rationale behind this choice is discussed below.

First, the two research questions stated above are concerned with acquiring an understanding of and the insight into various aspects of tax compliance practices and its process in large businesses in a developing country. To obtain such understanding, a further subjective interpretation is necessary. Hence, the general approach pursued in this research is the interpretative approach since it is the most appropriate given the phenomenon of interest. As argued by Ahrens and Chapman (2006), the interpretative approach accommodates the validity of the internal situation that exists in the field during the data collection and data analysis stages. Consequently, the meaning or the interpretation of the data may become more fluid and may result in multiple layers of meaning or even various levels of interpretation (Abernethy, Chua, Luckett & Selto, 1999). For example, the responses from participants lacked consensus on a particular factor that affects corporate tax compliance such as the factor of business profitability vis-à-vis reputation. Table 4-2 below presents the paradigm characteristics of interpretivism that are used in this study.

<table>
<thead>
<tr>
<th>Feature</th>
<th>Interpretivists stance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ontology (nature of reality)</td>
<td>Multiple, constructed realities exist</td>
</tr>
<tr>
<td>Epistemology (the relationship of the knower to the known)</td>
<td>Inseparable</td>
</tr>
<tr>
<td>Axiology (the role of values in inquiry)</td>
<td>Value-bound</td>
</tr>
<tr>
<td>Generalisation of time and context</td>
<td>Not possible</td>
</tr>
<tr>
<td>Logic</td>
<td>Inductive (particular to general)</td>
</tr>
</tbody>
</table>

Source: Tashakkori and Teddlie (1998, p.7-10)

Second, the key criterion for successful qualitative research concerns its rigour, which relates to the validity and reliability of findings resulting from strict adherence to the referenced theory and its relevance during the research process (Lamb, Lymer, Freedman & James, 2004). Otley (2001) suggests a specific technique to prevent the possibility of conflict between rigour and relevance. The technique involves making a direct connection with a real organisation and its daily operations by means of a field-
based research method to investigate a particular aspect of the organisation's practice. Consequently, the level of creativity and the researcher's insight into the process of investigation and data collection may determine the success of a qualitative study (McKerchar, 2008). Also, the past experiences of the researcher are a key factor in qualitative research, as the themes that emerge from the analysis may contribute significantly to an understanding of the factors that influence large business tax compliance. As noted by Denzin and Lincoln (2005, p.29), "Qualitative researchers report on their own observations of the social world, including reports of his/her experiences".

To conclude, the qualitative interpretative approach is appropriate for the research carried out for this study as it explores the perspectives of various participants. The selection of semi-structured interviews is intended to obtain comprehensive and detailed information about the practices of large businesses in regard to taxation. As argued by Denzin and Lincoln (2005, p.10), “The word ‘qualitative’ implies an emphasis on the quality of entities and processes and meanings that are not experimentally examined or measured regarding quantity, amount, intensity or frequency”. Hence, for the purposes of this study, the qualitative interpretative approach provided a more in-depth understanding of the social phenomenon of interest as it related to perspectives and human interactions (Bryman & Bell, 2011). Furthermore, statistics and other quantitative measures would be an inadequate means of exploring people’s behaviours, thoughts and feelings (Kalof & Dietz, 2008). In addition, the qualitative interpretative method was chosen for this study as the most suitable for addressing the research questions. Hence, the research questions, the theoretical framework, and the collected data should be aligned in order to produce valid and reliable findings (Torgler, 2007). In this study, those qualities are embedded in the qualitative research because the expected information is the knowledge that comes from contextual understanding and the participants’ rich experiences. This method also allows the researcher to have a broader access to the interviewees’ perceptions and their knowledge about the phenomenon of interest. Thus, the qualitative interpretative approach enables the researcher to explore the insights and the rationale behind company decisions regarding tax compliance.
4.3.2 Theory

Another key concept is the theory. Choosing the correct theory is not only important as the explanatory concept but also as a device to provide a fuller understanding of the process that occurred within the ongoing research. Moreover, unprompted insights could be elicited by the researcher’s interaction with the organisations’ members (Llewelyn, 2003). The critical concept in this study is related to a particular framework to support the explanation of the research problem. Therefore, the explanatory conceptual framework in this study represents an array of relevant literature, as suggested by Hopper and Hoque (2006) that is used to examine the similar dimension of a research problem. In this study, as the events in the field might best be explained with reference to multiple theories (Ahrens & Chapman, 2006) then the theory in relation to tax compliance and its supporting literature were chosen in order to acquire a deeper understanding of large business tax compliance issue in a developing country.

The selection of tax compliance literature and the responsive regulation approach in this study is intended to obtain a more comprehensive understanding of the practice of and the processes of large businesses tax compliance including the factors that influence their compliance. Moreover, this literature is selected because responsive regulation promotes persuasion and encouragement as an effective means of improving tax compliance (Braitwaite, 2000) and this notion is supported by Leviner (2009, p.1), “responsive regulation may, therefore, constitute a superior method for regulating tax compliance”.

4.3.3 Domain

The term ‘domain’ in this study refers to the space where the research took place and, more importantly, the field which was deemed the most useful for answering the research questions. The field of a domain might be seen as simple because it is the venue where data is collected. However, the usefulness of the field, in fact, might determine the accuracy of the researcher’s responses to the disclosed research problems. As noted by Ahren and Chapman (2006, p.824), “where, how and when the
researcher exposes him/herself to such data is determined by theoretical and methodological considerations”.

In the field, the careful exposition is applied by the researcher at the time of open-ended interaction between himself and his participants because such interactions may result in the obtaining of complicated, extensive and unnecessary data. The over-abundance of data may impede the researcher’s focus on answering the specified research questions. Also, there is the possibility that interviewees may challenge researcher’s thoughts or ideas or may even create a confrontation. However, unlike laboratory experiments, the interactions among humans in this study offered the researcher the opportunity to gather various perspectives, even though some might have been quite unique or even absurd. However, these characteristics enriched the quality of the study since the researcher was always mindful of the study objectives.

4.3.4 Research Method

As this study attempted to capture various perspectives in order to analyse the issue of large business taxation compliance in Indonesia, the selection of three different groups of participants with their interrelated functions namely, tax officials, tax managers and tax advisors, was intended to address the issue. These three groups were directly involved in the tax system, and they were well-positioned to determine their respective companies’ taxation compliance. Moreover, the views of these participants provided holistic pictures of the problem being addressed. Thus, both valuable information and more profound insightful perspectives were obtained from the participants.

As previously stated, because this study was conducted in order to acquire a deeper understanding and more comprehensive insights regarding the tax compliance of large businesses in Indonesia, hence, a semi-structured interview approach was selected as the most suitable method for collecting data. This method allows the researcher to address an array of themes based on the research problems presented in Section 4.2 above. Further, the semi-structured interview enabled the researcher to be flexible while keeping his focus on particular issues. This method also encouraged spontaneity which meant that the researcher could express his thought with some degree of
freedom as stated by Horton, Macve and Struyven (2004). Moreover, as argued by Pedhazur and Schmelkin (2013), the semi-structured interview has advantages compared to the other research method by, for instance, addressing more complex questions, providing opportunities to probe the interviewee’s responses, and identifying previously-undetected errors.

The other two interview approaches, namely the unstructured interview and the structured interview, were not selected for several reasons. The highly unstructured interview approach requires a significant amount of time for the collection of data, and the researcher has less control in directing the conversation to the topic that is supposed to be the primary focus. Moreover, as argued by Zhang and Wildemuth (2009), the researcher faces greater challenges when attempting to analyse the abundance of data collected from the interview. Meanwhile, the other method, the structured interview does not allow the researcher to pursue ‘interesting’ issues that may arise during the interview (Patton, 2005). Further, the structured interview also might raise the issue of data reliability or ‘true responses’ because participants are being directed to answer, or they forced to choose among alternatives provided. Therefore, the structured interview could be perceived as creating tension and intimidating the interviewee, which might result in a limited rapport between the interviewer and the interviewees, thereby possibly biasing participants’ responses.

Therefore, the semi-structured interview was selected for this study. It was conducted in two stages: the preliminary interview and the core interview. The first stage of the interview and the second stage are discussed further in section 4.4.1. The responses to questions asked in the interviews were then analysed by coding the answers and subsequently isolating the key themes, and finally grouping them according to the corresponding research questions of this study.

**4.4 Data collection and analysis**

Prior to conducting the field research, ethics clearance was acquired for a low level of risk research category. The study was approved by the RMIT University Business College Human Ethics Advisory Network (BCHEAN) under the Notice of Approval, Project number 18984 (see appendix D for detail).
As previously mentioned in subsection 4.3.4, the data was collected from semi-structured interviews. Moreover, the researcher's background as a tax officer was advantageous as it enabled him to understand the problems thoroughly and to identify the appropriate questions to be asked, particularly in terms of the local context. Subsequently, separate preconceived themes were established for the three different groups according to their respective functions. The details of the interview process of the study are discussed in subsection 4.4.1.

Subsection 4.4.2 discusses the process of data analysis. The analysis in this study followed Lillis' (1999) proposition that the analysis involves the process of sound reduction, appropriate classification and adequate interpretation. However, as anticipated, the transcript of the interviews and the post-interview notes constituted a significant amount of data that required painstaking analysis. Therefore, in this study, the researcher followed Patton’s (2002) suggestion, to be aware of the challenges associated with the analysis of a large volume of data so that the results are valid.

4.4.1 The interview process

The interview is one of the most potent methods for collecting data in qualitative research (Silverman, 2013). The face-to-face interview offers a more personalised interaction between the participants and the interviewer during the conversation. The interviewer can also probe or follow up the questions. Another significant advantage of the face-to-face interview, according to Opdenakker (2006), is that more spontaneous responses can be obtained from the interviewee without any prompting and, moreover, so that the interviewer has the advantage of observing social cues or non-verbal responses such as body language, and of changes in tone.

Two interview stages were conducted in this study. The first phase involved preliminary interviews that were conducted with five tax officials. The purposes of these were as follows:

a. to establish a foundation regarding what is considered as critical to large business tax compliance;

b. to provide insights into the type of information that the interviewee may be willing to offer; and
c. to create a useful framework for the second interview phase.

This study followed David and Sutton (2011) suggestion that a preliminary interview session be conducted prior to the core interview. One advantage of the preliminary session is that it establishes a basis for the interaction between the researcher and the interviewees. Also, it enables the researcher to rehearse the interview and ascertain the participants’ understanding of the questions asked. As a result, the feedback obtained from the preliminary session was valuable as it led to the revision of the proposed questions and enabled the researcher to estimate the average time needed for each interview.

For the core interview, the participants were recruited via various avenues. For example, tax officials (the first group of participants) were recruited after the researcher received approval from the Directorate of Human Relations of Directorate General of Taxes (DGT). The officials were recruited from the Large Taxpayer Office One, the Large Taxpayer Office Two, the Regional Large Taxpayer Office and the Directorate of Tax Potential, Compliance and Revenue. The researcher followed up the candidates by contacting them via a formal letter, email and telephone to determine their availability to participate in the study.

In the second group, tax advisors were recruited according to the leading firm’s classification from the International Tax Review (2015), a worldwide media for tax advisory practices. The researcher made contact with tax advisors who held various positions ranging from Partner, Director and Senior tax consultant and invited them to participate in this study. The group of tax managers was recruited from large taxpayers that were registered with the Large Taxpayer Office in Indonesia. Tax directors and tax managers were contacted via email and telephone to determine their interest in participating in the research. There were 101 potential participants contacted from all groups. However, 47 of them did not reply to the researcher’s email and six of them refused to be interviewed, leaving 48 interviewees for this research. Participant groupings are presented below in Table 4-3 below.
Before the interview session began, the researcher handed the participant a copy of a letter of participant information and consent form, the explanation about the research and the interview questions upon participant request. Further, the researcher informed each participant that participation was totally voluntary, the participant could withdraw at any time without providing an explanation, and all responses would remain confidential unless the participant gave specific permission for disclosure of information. The interview questions and the consent form are provided in Appendix C and E.

The interview was conducted with 48 participants comprising three separate groups. As presented in Table 4-3, 21 tax officials, 14 tax advisors and 13 tax managers were interviewed. All of those interviewees were selected by means of the purposive sampling approach. Purposive sampling is commonly used in qualitative studies since there are no exact rules governing the size of the sample population (Kaczynski, Salmona & Smith, 2014). This approach requires that potential participants be identified according to their personal knowledge or professional recommendation from their colleagues (Doyle, Hughes & Glaister, 2009). Patton (1990) asserts the advantages of purposive or selective sampling that the power of purposive sampling lies in the selection of information-rich sources. In this case, “The information-rich sources are those from which one can learn a great deal about issues of central importance to the purpose of the research” (Patton, 1990, p.169). Therefore, all participants in this study were considered to be information-rich. They were also key-informants because of their knowledge of the specific issue which was the focus of this study. It is worth noting that the tax directors or tax managers interviewed in this study are regarded as corporate elites, and their exclusivity makes them valuable key

### TABLE 4-3 PARTICIPANT GROUPS CONTACTED AND INTERVIEWED

<table>
<thead>
<tr>
<th>No.</th>
<th>Category</th>
<th>Contacted</th>
<th>Responded</th>
<th>Refused to be interviewed</th>
<th>Agreed to be interviewed and to be recorded</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Tax Official</td>
<td>25</td>
<td>25</td>
<td>4</td>
<td>21</td>
</tr>
<tr>
<td>2.</td>
<td>Tax Advisor</td>
<td>28</td>
<td>15</td>
<td>1</td>
<td>14</td>
</tr>
<tr>
<td>3.</td>
<td>Tax Manager</td>
<td>48</td>
<td>14</td>
<td>1</td>
<td>13</td>
</tr>
</tbody>
</table>
informants. As stated by Welch, Marschan-Piekkari, Penttinen and Tahvanainen (2002), access to the elites may be limited to only certain people because of their exclusivity in terms of the rest of society as a result of boundaries established by differences in status.

The interviews were conducted from 5 January 2015 to 6 November 2015. Each interview session was conducted at a time and place chosen by the participant. A voice recorder was used during the interview session upon the interviewee’s approval. Silverman (2011) argues that using a digital voice recorder provides more advantages compared to a field note. The advantages are that it can be replayed, it has a better preservation of the interview content, it makes the interviewee more relaxed and focused during the interview because s/he is not distracted by the interviewer writing down all the responses. In addition, the interviewer took notes during the session only to capture and followed up several interesting themes that emerged. Interviews took from 16 minutes (shortest) to 77 minutes (longest). All interviews were conducted in the Bahasa Indonesia language.

Interviews were carried out with three specific groups with various levels of position within respective organisations. For example, in the tax official group, interviews were conducted with people holding positions ranging from head of regional tax office to tax auditor. The tax advisor group comprised from the members of the “Big Four” firms to the Tier 3 ranks. In the tax advisor group, interviewee positions ranged from partner, director to senior tax advisor. The participants in the tax manager group were selected from various industries such as the oil and gas, plantation, mining, automotive, banking, consumer goods and pharmaceuticals. The company status either as a multinational corporation or a local company also became a concern. The detail of the participant’s criteria, category and number of interviewees are presented in Table 4-4 below.

All interviewees gave their full cooperation and responded sufficiently to all questions asked of them during the face-to-face interviews. Most interviewees gave answers concerning the current practices of the DGT and also implied several of its shortcomings. However, some participants requested that some of their responses be off the record because of the sensitive nature of the information. Such responses were not included in the data analysis. Most of the participant appeared to be relaxed and
willing to respond to all questions. However, some interviewees seemed uncomfortable, nervous and cautious at some point during the interview, although this did not reduce the overall quality of the interviews. Therefore, the researcher was confident that through the semi-structured interview method, rich data was collected from participants thereby contributing to achieving the study’s objectives.

TABLE 4-4 THE PARTICIPANT CRITERIA, CATEGORY AND NUMBER

<table>
<thead>
<tr>
<th>Participant</th>
<th>Criteria</th>
<th>Category</th>
<th>Number of participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Official</td>
<td>Ranks</td>
<td>Head of Regional Office</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Head of Tax Office/ Head of Division</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Head of Section</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tax Auditor</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Account Representative</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The Objection Reviewer</td>
<td>1</td>
</tr>
<tr>
<td>Tax Advisor</td>
<td>Firm ranks</td>
<td>Member of the Big Four</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tier 1</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tier 2</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tier 3</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>Position ranks</td>
<td>Partner</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Director</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Senior tax advisor</td>
<td>2</td>
</tr>
<tr>
<td>Tax Manager</td>
<td>Industry</td>
<td>Oil and Gas</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Plantation</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mining</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Automotive</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Banking</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Consumer goods</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pharmaceuticals</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MNC</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Private local owned</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>State-owned enterprise</td>
<td>2</td>
</tr>
</tbody>
</table>

The sample size of 48 participants in the study was adequate in terms of reaching data saturation; hence, the sample was sufficient for the purpose of validity and reliability of the research findings. As argued by Francis, Johnston, Robertson, Glidewell, Entwistle, Eccles and Grimshaw (2010), data saturation is a certain point in data collection process when no new data is being added to the information already
obtained in relation to the research questions. Reaching data saturation is an essential concept in qualitative research because, in the context of eliciting the interviewees' views or their experiences, it could result in the complexity of multiple views about the subject of interest or in the collected data not being strictly aligned with the purpose of the study. Regarding adequate sample size, Creswell (1998) argues that a range of 20 to 30 interviews undertaken for a qualitative project would be sufficient. Also, Charmaz (2006, 114) as cited by Mason (2010), argues that about 25 participants would be adequate. While Green and Thorogood (2009) as quoted in Mason (2010, p.4) state that "the experience of most qualitative researchers (emphasis added) is that in interview studies little that is 'new' comes out of transcripts after you have interviewed 20 or so people". Therefore, the researcher considered that 48 interviewees were an adequate number for this study.

4.4.2 Data analysis

This data analysis section discusses the analysis conducted in the study. The discussion of this section begins with thematic analysis as a selected data analysis tool, transcription, coding, development and interpretation of themes and sub-themes.

4.4.2.1 Thematic Analysis

This study used thematic analysis to analyse the collected information. Braun and Clarke (2006) defined thematic analysis as a method used to identify, analyse and report the pattern of themes in the collected data, which assists the researcher to organise the data set and describe it in rich detail. Howitt and Cramer (2007) defined thematic analysis as an analysis of textual material that contains a major theme; whereas, the theme is a topic or a subject of a person thought, wrote or spoke.

The use of thematic analysis as stated by Jones and Forshaw (2012) involves coding texts, reading and rereading, and being aware of any recurring concept that emerges from the data. This confirms what was previously stated by Boyatzis (1998, p.4) that thematic analysis is “a process for encoding qualitative information”, requiring the researcher to engage in the coding process.
According to Boyatzis (1998), the coding process begins with an initial reading of all the data, dividing the text into segments of information, labelling segments of information with codes, reducing overlap and eliminating redundancy, and collapsing codes into appropriate themes. In this study, concepts of tax compliance, tax risk management and responsive regulation as presented in Chapter 3 are utilised as references to build relevant themes. This thematic analysis method gives some flexibility to the process of data analysis, allowing researchers with various methodological backgrounds to apply multiple theories and to engage in this type of analysis (Braun & Clarke, 2006). Thematic analysis is also appropriate for addressing research questions that are beyond the researcher’s experience. The thematic analysis approach is appropriate for researchers who need to get close to their data and develop a thorough appreciation of the content. However, this method faces the problem of reliability because of the possibility of various interpretations that resulted from the themes. To overcome this issue, this study monitored the selected themes continuously and encoded the data throughout the process carefully as suggested by Guest, MacQueen and Namey (2012). The following table summarises the advantages of thematic analysis.

**TABLE 4-5 THE ADVANTAGES OF THEMATIC ANALYSIS**

<table>
<thead>
<tr>
<th>Flexibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relatively quick and easy method to learn, and do</td>
</tr>
<tr>
<td>Accessible to researchers with little or no qualitative research background</td>
</tr>
<tr>
<td>Results are generally accessible to an educated general public</td>
</tr>
<tr>
<td>Useful method for working with participants as collaborators</td>
</tr>
<tr>
<td>Can usefully summarise key features of a large body of data, and/or offer a ‘thick description’ of the dataset</td>
</tr>
<tr>
<td>Can highlight similarities and differences across the data set</td>
</tr>
<tr>
<td>Can generate unanticipated insights</td>
</tr>
<tr>
<td>Can be useful for producing qualitative analyses suited to informing policy development</td>
</tr>
</tbody>
</table>

Source: Adapted from Braun and Clarke (2006, p. 97)
The researcher later conducted three stages of thematic analysis following the suggestions of Boyatzis (1998) and Braun and Clarke (2006):

1. Transcribing textual data. The process began with reading and transcribing the material collected from the interviews. The whole process from interview, transcription to the translation of the text assisted the researcher to connect with the data from the beginning of and during the analysis. The purpose of reading, rereading and transcribing data is to increase researcher’s familiarity with his data.

2. Data analysis. The efforts conducted in this study were: (a) the researcher developed familiarity with the text obtained through the semi-structured interviews by transcribing and translating the interview texts in order to achieve understanding and avoid partial knowledge of the data; (b) in order to obtain the fine details comprising the data, the researcher analysed each sentence as well as the entire transcript of each participants’ interview data in order to ascertain and summarise the overall themes; (c) the researcher processed and re-processed the data to ensure its relevance; (d) the researcher, together with his supervisors, addressed the difficulties, and checked and rechecked the compatibility between the data analysis and the data themes.

3. Identifying themes and sub-themes. The researcher developed and refined the themes that emerged from the analysis and ascertained the extent of their alignment with the existing literature.

4.4.2.2 Coding

The coding process conducted in this study followed the suggestion of Boyatzis (1998) that is the process of encoding qualitative data in order to analysing it. It also the process involves applying codes to the data so that the similarities and differences between texts can be highlighted. According to David and Sutton (2011), a code is a keyword, phrase or theme that may or may not correspond to the requirements in the analysed texts. Moreover, coding helps the researcher to eliminate unnecessary data and retain only the information that is relevant to the area of interest.
Before commencing the coding process, the researcher undertook the transcription and translation of the interview data since the interviews were conducted in the local language, Bahasa Indonesia. The researcher translated the interview questions from English to Bahasa Indonesia; then the interview information gathered in Bahasa Indonesia was translated back into English. To ensure the accuracy of the translation, a random sample of the interview transcripts was checked by an independent person who is competent in both languages. This person’s feedback and suggestions were used to perfect the translated transcription. The following table provides the sample of two fragments of revised transcripts\(^\text{39}\).

**TABLE 4-6 REVISED INTERVIEW TRANSCRIPTS TRANSLATION**

<table>
<thead>
<tr>
<th>No.</th>
<th>Fragment of transcript in Bahasa Indonesia</th>
<th>Original translation to English</th>
<th>Revised translation to English</th>
</tr>
</thead>
</table>
| 1.  | *Jadi ini juga sebetulnya tantangan juga ya bahwa bagi administratur pajak bagaimana bisa memandang atau memperlakukan Wajib Pajak-Wajib Pajak Besar ini dengan cara yang efektif, efisien, lebih penting lagi adalah trust-nya.* *(TM04)* | So it’s also a challenge, too, that for tax administration how to view or treat these Large Taxpayers in an effective, efficient way, more important is their trust. *(TM04)* | Feedback received: Omit the word ‘too’ ‘efficient’ and the sentence needs to be softened  
Revised translation:  
So it is a challenge for a tax administration on how to view or to treat the large taxpayers in such effective way by earning their trust. *(TM04)* |
| 2.  | *Eh, saya pikir pertama trust ya. Trust kepada eh bagaimana selama ini mereka di-treat oleh, ck, negara ya secara umum-- Dengan oleh otoritas pajaknya ya.* *(TA02)* | Uh, I think first trust yes. Trust to eh how they have been treated by, ck, country yes in general-- By by the tax authorities yes. *(TA02)* | Feedback received: Omit the stuttering ‘by’ and unnecessary interjections such as ‘uh’ ‘yes’ and the sentence needs to be softened  
Revised translation:  
I think first is about trust. Trust to the nation in which in this case on how they are being treated by the government, by its tax authority. *(TA02)* |

\(^{39}\) For the reader’s information, the researcher made a coding differentiation of the interviewees based on their participant group tax officer, tax advisor or tax manager. Code TO refers to a tax official, code TA to a tax advisor and code TM to a tax manager respectively. The number after the code, for example as shown in the Table 4.6 – TA02, indicates the sequence of the participants in alphabetical order. This segregation of codes is intended to provide nuances of response from the participant for a similar question as well as to enrich the insights that can be drawn from each participant’s experiences.
When the transcriptions and the translations of the interview data were completed, the researcher began the coding process. As stated by Miles et al. (2014), coding is a deep reflection of in-depth analysis and interpretation of the data meanings. Meanwhile, codifying requires organising or categorising the data systematically, and placing it into a section of a particular system or classification (Saldana, 2013). This coding and codifying mechanism enables the researcher to retrieve and categorise chunks of similar data so that s/he can easily locate, extract or cluster the segments that are related to a specific research question or theme.

The process of clustering of the condensed data helps the researcher to establish the steps for further analysis and inferences drawn from the analysed data (Miles et al., 2014). According to Boyatzis (1998), the coding process begins with an initial reading of the data, then dividing the text into segments of information, labelling segments of information with codes, reducing overlap and redundancy and collapsing codes into appropriate themes. In this study, the researcher followed the abovementioned coding steps suggested by Miles et al. (2014) and Boyatzis (1998).

Following the transcription and translation of all the interview data, the researcher utilised NVivo software to assist him with data coding. NVivo is a qualitative data analysis software package that has been widely used by many qualitative researchers to support their analysis. The software's ability to record, sort, match and link the data allowed the researcher to obtain a more accurate answer to his research questions without losing access to the source data. Hence, it can be argued that the use of this software for qualitative analysis produces a more rigorous analysis and, therefore, enhances the reliability of findings (Bazeley, 2013). Further, Saldana (2013) explained that the NVivo coding uses short phrases or words from the participant’s original voice as a code marking in the record. By marking the code in their original language, Saldana (2013) further argued that there were values in respecting the original voice of participants and the NVivo acted as the first gate in coding the data before continuing to the analysis process. Therefore, the NVivo was selected for this study because it greatly assisted the researcher to refine the themes, to elicit the relevant meanings from the data and to establish the credibility of the findings. As stated by Oats (2012), it will convince the readers of the value of the study. Figure 4-1 below summarises the process of data analysis used in this study.
4.4.2.3 Developing and interpreting theme/sub-theme

Boyatzis (1998, p.161) defined a theme as “a pattern in the information that at a minimum describes and organises the possible observations and at a maximum interprets aspects of the phenomenon”. Hence, a theme captures something important about the data that have particular patterns or specific meanings with respect to the research question. A theme itself may be given sizable space in some data segments, and little to none in others, or it may appear in relatively little of the data set (Braun & Clarke, 2006). Moreover, the importance of a theme does not depend on the quantifiable measures but on its function – that is, whether it captures something relevant in relation to the aim of the research question. Braun and Clarke (2006) state that the researcher’s judgement is crucial when determining the themes that is relevant to the research question.

In this study, the researcher followed the suggestion of Braun and Clarke (2006) and Boyatzis (1998) where the function of the theme is to capture what is relevant to the research question. Therefore, both of the research questions stated in this study guided the theme development in the data analysis stage. The literature on tax compliance, tax risk management and responsive regulation as presented in Chapter 3 is utilised as references to build relevant themes as suggested by Braun and Clarke (2006).

Before embarking on the field research, some pre-established themes from the literature review such as the concepts of tax compliance, tax risk management and responsive regulation have emerged in the researcher’s review notes and, as Basit (2003) stated, they required answers. After extensive research, more specific themes relating to those concepts were discovered in the literature and, as Mc kerchar (2010)
argues, the discovery of relevant themes is one of the most critical tasks in qualitative data analysis.

The researcher identified several themes to support a more detailed analysis of themes relevant to this study by referring to the categories established by van der Hel-van Dijk-van Dijk, and Siglé, (2015) for the factors that influence corporate tax compliance. As the themes identification process continued, the researcher refined the themes and sub-themes, placing them into their appropriate categories so that each category was grouped according to a specific code and its respective associations. The list of the major themes, the associated sub-themes and the references is presented in Table 4-7 below.

To summarise, for the data analysis process, the researcher referred to the literature on large-business tax compliance in order to categorise the results of the interview into designated themes. The literature was also utilised to map and evaluate whether the participants' responses were in accordance with the findings of previous studies. This means that the themes for this study were developed from the voices of participants in previous studies. After the data coding and theme insertion were completed, the researcher arranged the verbal description regarding research questions. To check the consistency of judgment and to ensure reliability, the researcher clustered the various themes in order to provide clarity and in-depth analysis. Figure 4-2 below indicates the flow of the coding and analysis process applied in this study.

<table>
<thead>
<tr>
<th>Quote</th>
<th>Coding</th>
<th>Theme</th>
<th>Subtheme</th>
<th>Research Questions</th>
</tr>
</thead>
</table>
| "So, it is a challenge for a tax administration on how to view or to treat the large taxpayers in such an effective way by earning their trust." (TÅox) |  ‘trust’  
  ‘tax administration’  
  ‘challenge’ | Socio-psychological factors  
  Managing non-compliance | Trust  
  Personal norms  
  Social norms  
  Reputation | RQ 1  
  RQ 2 |

*FIGURE 4-2 THE FLOW OF THE CODING AND ANALYSIS PROCESS*
<table>
<thead>
<tr>
<th>No.</th>
<th>Compliance Drivers</th>
<th>Themes</th>
<th>Subthemes</th>
<th>References</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Corporate Factors</td>
<td>Economic factors</td>
<td>Cost-benefit driven decision</td>
<td>Becker (1967); Allingham &amp; Sandmo (1972); Yitzhaki (1974); Kinsley (1992); McKerchar (2002); Eichfelder &amp; Kegels (2014);</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Manager compensation</td>
<td>Taylor &amp; Richardson (2004); Crocker &amp; Slemrod (2005); Rego &amp; Wilson (2012); Phillips (2003); Armstrong et al., (2012); Powers et al., (2013)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Detection probability</td>
<td>Strumpel (1969); Dublin et al., (1990); Alm et al., (2012); Gangl et al., (2013); Chen &amp; Chu (2005); Morse (2009)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Risk appetite</td>
<td>Skinner &amp; Slemrod (1985); COSO (2011); Deloitte (2008); Blakerlock &amp; Whitney (2015)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Uncertainty</td>
<td>Casey &amp; Scholz (1991); Taylor &amp; Richardson (2013)</td>
</tr>
<tr>
<td></td>
<td>Socio-psychological factors</td>
<td>Personal norms</td>
<td>Bobek et al., (2007); Wenzel (2007); Traxler (2010); Torgler (2007)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Social norms</td>
<td>Bobek et al., (2013); Wenzel (2005); Torgler (2007); Blanthorne &amp; Kaplan (2008)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Trust</td>
<td>Torgler (2003); Torgler (2008); Kirchler (2007); Taylor (2002); De Mello (2009); Bird (2008); Chema (2010); Blind (2010); Turner (2005); Richardson (2008); Kirchler et al., (2008)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Reputation</td>
<td>Cooper (1994); Oats &amp; Tuck (2008); Toumi (2009); Mulligan &amp; Oats (2009); Graham et al., (2013); Erle (2008); Gallemore et al., (2014); Lavermicocca (2011); Williams (2007); Ford (2005); Loretz &amp; Moore (2013); Lavermicocca (2009)</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>External Factors</td>
<td>Tax risk management</td>
<td>van der Hel-van Dijk-van Dijk, &amp; Siglé, (2015); Segal et al., (2017); Daniel (2008); van Daele &amp; van der Elst, (2010)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ownership structure</td>
<td>Hanlon et al., (2005); Desai &amp; Dhapalapa (2006); Slemrod (2007); Chen et al., (2010); McGuire et al., (2012); Badertscher et al., (2013)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Financial constraints</td>
<td>Edward et al., (2016); Law &amp; Mills (2015); Dyreng &amp; Markle (2015); Akamah et al., (2016); Richardson (2015)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tax advisor</td>
<td>Klepper &amp; Nagin (1989); Spilker et al., (1999); Tan (2011); Wurth &amp; Braithwaite (2016)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Regulation factors</td>
<td>Complexity</td>
<td>Baurer (2005); Ososky (2011); Agha &amp; Haughton (1996); OECD (2004); Cuccia &amp; Carnes (2001)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ambiguity</td>
<td>Agha &amp; Haughton (1996); Erle (2008); Cuccia &amp; Carnes (2001); Sandmo (2005); Kirchler (2007)</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Unfairness</td>
<td>Guerrero (2011); OECD (2004); Sunshine &amp; Tyler (2003); De Mello (2008); Mascagni et al., (2014); Nadler (2002)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Regulatory overlap</td>
<td>Ahdieh (2006); Aagaard (2011); Li (2015); Middleton (2014); O’Callaghan (2010)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Modified from van der Hel-van Dijk-van Dijk, and Siglé, (2015, 766) and Yusof and Lai, (2014, 430)
### TABLE 4-8 OVERVIEW OF DRIVERS, THEMES, SUB-THEMES AND REFERENCES IN RELATION TO THE SECOND RESEARCH QUESTION

<table>
<thead>
<tr>
<th>No.</th>
<th>Compliance Drivers</th>
<th>Themes</th>
<th>Subtheme</th>
<th>References</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>The institutional capacity</td>
<td>Human resources issue</td>
<td>Integrity and corruption</td>
<td>Flatters &amp; Macleod (1995); Picur &amp; Riahi-Belkaoui (2006); Bird et al. (2008); McKerchar &amp; Evans (2009); Bird &amp; de Jantscher (1992), Rosid et al. (2016)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Lack of professionalism</td>
<td>Baer &amp; Silvani (1997); Braithwaite &amp; Wirth (2001); Lushi (2016); Höglund &amp; Nöjd (2014), Widihartanto &amp; Braithwaite (2016)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Lack of sufficient human resources</td>
<td>Baurer (2005); Gallagher (2005); Baer &amp; Silvani (1997); Muhammadi et al., (2016); Widihartanto &amp; Braithwaite (2016); Korte (2013);</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Poor data management</td>
<td>Tanzi &amp; Zee (2000); Baer &amp; Silvani (1997); Torgler (2003); Kidd &amp; Crandall (2006); Korte (2013)</td>
</tr>
<tr>
<td>2.</td>
<td>Managing noncompliance</td>
<td>Detecting noncompliance</td>
<td></td>
<td>Arnold (2008); Brondolo et al. (2008); OECD (2009); DGT (2016); OECD (2001)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Managing noncompliance</td>
<td></td>
<td>Lerche (1980); McKerchar &amp; Evans (2009); Ayres &amp; Braithwaite (1992); Braithwaite (2006); OECD (2001); DGT (2016).</td>
</tr>
</tbody>
</table>

Source: Modified from Arnold (2008, 30) and Baer and Silvani (1997, 2)
Figure 4-2 demonstrates an example of coding and analysis process from the beginning- the quote until the last step, answering the suitable research question. In detail, firstly, the researcher coded a quote from a participant’s interview transcription and labelled it with ‘trust’, ‘tax administration’ and ‘challenge’. After the initial data from the transcription was coded, the next step was to categorise the coded data according to the appropriate theme with regard to the previous literature. In this stage, the codes were allocated to their appropriate themes and sub-themes. For example, ‘trust’ was categorised as related to the theme of ‘Socio-psychological factors’ and later grouped under the sub-theme of ‘Trust’. Finally, in the last stage, the researcher linked the coded data from the sub-theme category to the appropriate research question.

4.5 Reliability and Validity

Eisner (2017) argues that a good qualitative study can help its reader to understand a complicated or confusing situation. In a qualitative study, the reliability refers the extent to which the reader acquires an understanding of the phenomenon of interest; in a quantitative study, reliability refers to the quality of the research and its ability to accurately explain a problem (Stenbacka, 2001). In a qualitative study, an examination of the trustworthiness of the study report is essential to ensure its reliability (Seale, 1999). Therefore, the researcher’s skill and ability in undertaking a qualitative study will determine its reliability (Patton, 2002).

In a qualitative study where the interview was used to collect data, the aspect of reliability pertains to the consistency of judgment and trustworthiness of the research findings (Kvale & Brinkmann, 2009). Further, they argue that the interviewer’s technical ability in formulating leading questions can determine the reliability since the responses from the interviewees are influenced by the style and the approach of the interviewer. The next issue related to the reliability of interview is the accuracy of the transcription and translation. To address this issue, Kvale and Brinkmann (2009) suggest using two independent persons to each transcribe the same interview and compare the two transcriptions.

Also related to reliability is the accuracy of the interpretation of transcripts which raises the issue of subjectivity and the consistency of judgment. Boyatzis (1998) argues
that the consistency of judgment will protect the researcher against or at least lessens
the contamination of projection bias. Moreover, he explains that there are two basic
forms of consistency of judgment: (i) the consistency among various readers; and, (2)
the consistency over time, events, or settings. Therefore, the reliability of a qualitative
study is influenced by the way in which the data is recorded and the selection of the
subjects that were recorded.

Regarding validity, there is no consensus among qualitative researchers regarding
validity, since this is regarded as an attribute of quantitative study (see, for example,
Altheide & Johnson, 1994; Hammersley, 1987). Nevertheless, some researchers argue
that it is necessary for a qualitative study to be checked or be measured by specific
criteria (see, for example, Creswell & Miller, 2000; Yardley, 2007; Morse et al., 2002).
Creswell & Miller (2000), for example, state that the validity is affected by the
researcher’s paradigm assumption and his perception of validity; hence, they suggest
using the method of triangulation to ensure the validity of a qualitative study.

The interview also can be used as a supporting tool of validity since the researcher is
able to corroborate participants’ responses from the record and compared them with
one another (Seidman, 2013; Weiss, 1994). Seidman (2013) argued that if the
interviewee was able to provide a logical response, then the interview was on the right
path toward validity. Further, Weiss (1994) added that rich, detailed accounts of vividly
recollected events are likely to be trustworthy information.

In this study, triangulation technique is used to ensure validity and reliability since the
key assessment criteria of a high-qualified research concerns the way in which validity
and reliability are addressed in the research (Lamb & Lymer, 2004).40 Creswell and
Miller (2000, p.126) define triangulation as a procedure to ensure validity where
“researchers search for convergence among multiple and different sources of
information to form themes or category in a study”. They further argue that the
credibility of a study can be validated by triangulation from the perspective of the
researcher. Denzin (1978) identified four aspects of triangulation works: data,
investigator, theory and methodology. Triangulation is typically used to enhance the

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40 The example of triangulation technique is data triangulation, member checking and disconfirming
evidence (Denzin, 1978; Creswell & Miller, 2000)
validity and reliability of a qualitative research or as a method to evaluate the findings (Maxwell, 1992). For this study, triangulation was used to ensure that the research findings were corroborated by and consistent with the findings of previous studies.

Data triangulation, member checking, and disconfirming evidence as suggested by Denzin (1978) and Creswell and Miller (2000) were applied in this study to check the validity and the reliability of the findings. In this study, data triangulation involved comparing the data obtained from the three groups of participants: tax officers, tax managers and tax advisors. The variation of answers to a similar question is intended to enrich the findings of this study with the experiences of the participants as the key informants. Further, this study sought to provide a balance of opinions among those directly associated with large-business tax compliance in Indonesia. It is a verification strategy recommended by Morse et al. (2002) to enhance the research validity.

Moreover, the interview data were also validated with relevant archival public records. The Law Number 7 of 1983 regarding Income Tax and the Law Number 6 of 1983 regarding Taxation General Provisions and Procedures were used as relevant references. Other Indonesian government rulings and regulations relating to tax compliance were also used as references. Secondary sources such as scholarly journal articles, the DGT's website (www.pajak.go.id), the Indonesian Tax Consultant Association website (www.ikpi.or.id), the Budget Statement from 2010 to 201641, the World Bank report, the IMF report and the OECD report were also used to support the arguments put forward in this study and to validate the interview data. For example, the tax officer participants generally felt that there were no issues regarding the way in which officers performed their services to taxpayers; however, the report from the IMF stated otherwise.

Creswell and Miller (2000) suggest employing the method of member checking to check the validity of the data from the perspective of participants. Therefore, the researcher sent the transcriptions by email to obtain feedback from the participants using the method of negative confirmation which means the participant has to respond only if s/he does not agree with any aspect of the transcription.

41 The Budget Statement is an explanatory policy document that accompanying the draft budgets at both national and local level.
Apart from the triangulation strategy as abovementioned, the researcher also applied another strategy to ensure the reliability and validity of the study. The researcher followed the suggestion of Miles and Gilbert (2005) to ask a ‘savvy reader’ to peruse the findings of the study and offer inputs and feedback. In this study, the savvy readers were the researcher’s supervisors. In addition, the use of purposive sampling in this study is also intended to provide a certain degree of reliability of the collected data quality since the participants were considered as key informants given their significant knowledge of and experiences with tax compliance issues in Indonesia, although their opinions might be inherently biased. This bias is anticipated by the method of disconfirming evidence as stated in the next paragraph.

Disconfirming evidence is a necessary procedure to support the validity of narrative data as well as data credibility (Creswell & Miller, 2000; Yardley, 2007). The process of disconfirming evidence in this study was conducted by comparing the opinions of participants with the predetermined themes. Later, the researcher recognised that it was important to take into consideration the differences in the participants’ opinions and the backgrounds. For example, before the interviews were conducted, it was anticipated that there would be differences in opinion regarding the issue of tax avoidance between the group of tax managers and the group of tax officers. Such differences were confirmed by the variations in the interviewees’ direct responses and implied suggestions.

4.6 Conclusion

A qualitative interpretative approach was used in this study to acquire an in-depth understanding of large business tax compliance risks in Indonesia and how the related tax authority is managing the issue. The qualitative approach was the most appropriate given the nature of the research questions and involved semi-structured interviews of selected participants. The purposive sampling method was used to ensure that the study identified the appropriate participants as key informants whose opinions would be relevant and valuable in addressing the research questions.

For this study, a thematic analysis approach was adopted to code and analyse the interview data. The process of coding, developing a theme and interpreting it were
applied to generate the findings. To ensure the validity and reliability of the study, the researcher applied the strategy of data triangulation, member checking and disconfirming evidence as well as asking ‘savvy reader’ to peruse the findings and offers feedback.
CHAPTER 5
FACTORS THAT INFLUENCE LARGE BUSINESS COMPLIANCE

5.1. Introduction

The previous chapter discussed the methodology used in the research, the justification for adopting five fundamental research concepts, and described the interview process. This chapter explains and discusses findings regarding the factors that influence large business’ compliance which emerged from the interviews. To be specific, this chapter outlines findings related to the first research question: *What are the factors that influence large business taxpayers’ compliance risks from the perspectives of the tax officials, the tax managers, and the independent tax advisors?*

The findings pertaining to the first research question that have been identified by participants are discussed in two sections: Section 5.2 - corporate factor, and Section 5.3 - regulation factor. Section 5.2 consists of three subsections in which economic factors, socio-psychological aspects and corporate characteristics are discussed. Section 5.3 consists of four subsections: ambiguity in regulation, uncertainty in regulation, regulatory overlap and unfairness in regulation. The summary in Section 5.4 concludes the chapter.

5.2 Corporate factors

Large businesses play a crucial role in the economy of a nation. The economic growth of large businesses, especially in developing countries such as Indonesia, is strongly linked to their revenue contribution to the state budgets. The growing budget over the years demands revenue contribution from large corporations; hence, the issue of corporate non-compliance has become a major concern. So, this section discusses in detail the risks associated with the factors of non-compliance from the internal perspective of large businesses.
Several tax researchers argue that the factors of non-compliance could be categorised into three major groups as discussed in the Literature Review in Chapter 3. These factors are related to the economy, socio-psychological features, and the characteristics of the corporation. This section adopts these categories as they facilitate the classification of findings and, furthermore, this makes it easier to compare the findings with those of past.

### TABLE 5-1 OVERVIEW OF CORPORATE FACTOR THEMES AND SUB-THEMES

<table>
<thead>
<tr>
<th>Compliance Drivers</th>
<th>Themes</th>
<th>Sub-Themes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate factors</td>
<td>Economic factors</td>
<td>Cost-benefit driven decisions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Compensation of manager</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Detection probability and penalty</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk appetite</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Uncertainty</td>
</tr>
<tr>
<td>Socio-psychological factors</td>
<td>Individual - personal norms and social norms</td>
<td>Corporate social norms-reputation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fairness and trust in government</td>
</tr>
<tr>
<td>Corporate characteristics</td>
<td>Tax risk management</td>
<td>Ownership structure and business size</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Financial constraints</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Use of a tax advisor</td>
</tr>
</tbody>
</table>

Table 5-1 above shows the factors that intrinsically influence large business compliance. This table corresponds with themes and sub-themes that are elaborated in Chapter 4 which discusses our methodology. They are discussed in this section to provide a clearer picture of the compliance drivers from the corporation perspective. Meanwhile, the findings discussed in this section are the factors that are considered

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42 The three groups comprise the economic, psychological and sociological factors, and the internal corporate characteristics factor.
relevant by key informants in Indonesia. Therefore, a different result may emerge if the research were conducted in another country.

5.2.1 Economic factors

The taxpayer is assumed to be a rational creature that is driven by logical decisions based on cost-benefit considerations. The economic factors imply that the compliance is achieved by means of fraud detection and the authorities’ application of severe penalties for non-compliance. Table 5-1 suggests that, according to the participants, five factors related to the economics factor were perceived as significant in influencing large business compliance. Interestingly, the cost-benefit decision and the risk appetite were the most common responses from the interviewees. This is consistent with the underlying notion of economic factors which assumes that a large business is a rational actor that makes judicious decisions.

5.2.1.1 Cost-benefit driven decisions

All participant categories tax officer, tax manager and tax advisor believed that the decisions made by corporations were based on cost-benefit considerations. This was evident when a company conducted transactions in such a way that taxes could be avoided and profits maximised, although this could attract the attention of authorities. A manager from the oil and gas industry pointed out that the priority was the interests of his company; when conducting transactions that were questionable in terms of tax avoidance, his company attempted as much as possible to maintain corporate compliance.

Because, there is a possibility of different interpretation regarding grey area in a regulation and in anticipating the DGT’s viewpoint that stance in their position, so we changed the transaction scheme... So, we decided to utilise the overseas entity... this transaction is commercially more profitable and ascertain legal certainty for both of us and the buyer. However, this treatment made the transaction become untaxable and the domestic authority losing their revenue (TM06).

Accordingly, a higher compliance cost is an issue for large businesses although Susila and Pope (2013) argued that the compliance costs of large companies in Indonesia are
low compared to those of other countries. However, the advancement of technology and the changes in the business environment have forced the tax authorities to catch up by developing a more sophisticated system to protect their interests as well. As stated by one of the top executives, the burden to comply was more expensive at the moment.

The compliance cost is getting higher because we want to comply, and we want to follow the requirement…. whether we like it or not, we must be ready to anticipate the ever-changing regulations and upgrading the system to follow compliance requirement is not cheap (TMo4).

At the other end of the spectrum, tax officials apparently considered that corporate taxpayers’ efforts to create efficient tax savings to maximise their profits sometimes crossed the line. It has become widespread practice for large businesses to exploit loopholes in regulations in order to optimise tax savings on the premise that they were not violating the prevailing law. A high-ranking tax office official confirmed such behaviour: "Even though there is no exact data to show, I guess they used the loopholes to avoid taxes" (TOt6).

Further, a tax auditor explained how a company could create tax savings through an aggressive tax planning scheme and how they dodged paying taxes. He admitted later that actions such as hiding sales turnover that was masked by the tax planning scheme had become more sophisticated and more difficult to detect during the audit. “For example, a legal entity who creates fictitious costs by concealing turnovers and using aggressive transfer pricing schemes whilst this scheme is hard for us to detect and counter” (TOo8).

Also, several officials paid closer attention to the dubious tax planning that was carried out by taxpayers, and they noticed that it was uncommon for the taxpayer to opt for lower profitability when tax planning. One official stated that taxpayers attempted in every way to act in their own interests regardless of stringent standards and regulations.
Typical audit finding for large business is the non-deductible depreciation expenses. Second, the issue of company’s expense whether it allowed for deductible or not because many expenses cannot be deductible due to the tax regulation, but it could be deductible commercially... Third, the issue of valuation (TO01).

Regarding tax planning, many tax advisors believed that tax planning schemes were part of regular business operations. They argued that applying tax planning in order to optimise the profit of a corporation was legally acceptable. It was performed in line with regulations, so they were not breaking the law. Aside from the moral obligation issue, another tax advisor believed that the problem of losing tax revenue could not be imputed to the tax planning practice but rather to the shortcomings of the law itself.

Tax planning is a common thing to do because it is a part of business planning... Perhaps the problem is something wrong with the regulation that causing loopholes that eventually being exploited by taxpayers. So, why should taxpayers take the blame? ... I think there is a leniency or weaknesses in the regulation and that is being exploited by taxpayers, but that type of tax planning is acceptable for me (TA01).

On the issue of cost efficiency in business, several tax practitioners perceived a corporation as a rational economic animal that always calculated its actions based on the cost-benefit consideration, regardless of the fact that the tax was more than merely a payment to his country. As pointed out by a senior practitioner, large corporations have calculated the consequences of every action undertaken, including how to weather the subsequent risks. "Of course, large companies came with long experiences; they calculated the tax effect of every transaction they made including if it results in dispute. They knew what to do; they knew the risks" (TA02). Further, an overpayment of tax seemed to be a failure on the part of a tax manager responsible for handling so-called efficient tax saving. A partner of another of the big five tax firms expressed his idea on this issue.

The company always tried to comply... But, all tax payments are costs. It is understandable that a company want to maximise their tax savings because tax payment is considered as costs. They comply with the stressing of no excessive payment or underpayment. It will be a failure for a manager to excessive tax. But, it is also a failure if
the company was audited and conceded many findings and the manager cannot manage it (TA14).

Interestingly, this advisor distinguished between a ‘safe’ tax planning scheme as opposed to an aggressive one. His phrase, ‘doing it and having good sleep’, gives an insight into the moral compass that should guide any tax planning scheme.

In short, if your tax planning scheme makes you sleep tight, it means safe and acceptable. However, if you feel inconvenient with the scheme, there is a possibility that you run into something that unacceptable although no rules are being violated (TA14).

Aside from the moral obligation that should not be overlooked, the consequences of aggressive tax planning need to be addressed. For example, if tax authorities challenge a dubious scheme and the matter is brought to court, the company may incur a massive amount of legal and other costs even if it thought that it was acting appropriately and not violating any laws or regulations.

I always say to my client, “if you are being more aggressive in your tax planning by creating transactions or setting schemes whereas the anti-avoidance rules still unregulated, perhaps you achieved your goal to create more tax savings. However, the consequence is you will have massive costs for tax dispute and the outcome also is uncertainty state. Well, maybe you could win your case, but you will suffer in every step of the dispute settlement process” (TA04).

The response from the advisor with more than fifteen years of experience indicated that the practice of tax planning was widespread. Nonetheless, the fine line between what is regarded as an acceptable practice and what is not depends on personal understanding or even the individual’s moral standards. The issue here is the absence of a system to gauge what is healthy tax planning with the inclusion of the moral standard.

The abovementioned findings suggest that the cost-benefit factor is an aspect that influences a company's decision. Further, some participants viewed a company as a rational economic animal that always calculated its actions based on the factors of cost
and benefits. Hence, the cost-benefit factor determines the way in which a company designs and implements its tax planning scheme.

5.2.1.2 Compensation of manager

According to some literature, another factor affecting non-compliance is the compensation of managers. The manager is responsible for minimising the tax burden and is encouraged by the incentives s/he will receive by reducing the company’s effective tax rate, thereby achieving higher profitability (Crocker & Slemrod, 2005). The prospect of receiving a larger annual bonus may tempt tax managers to seek any means of reducing the tax burden, and this potentially could lower the corporate tax compliance (Philips, 2003; Powers, Robinson, & Stomberg, 2013).

Regarding information about tax savings performance and manager compensation, participants were not asked explicitly during the interview about the relationship between their received compensation and their company’s tax savings performance. Instead, the question related to their company’s compensation system and how it worked. Most of the participants expressed that there was almost no correlation between the company’s performance and the size of bonus received. Some tax managers pointed out that the scheme of compensation was prearranged according to a specific formula and was therefore not directly related to the level of profitability. A tax manager involved in the plantation industry stated: "There is a formulated calculation for the bonus, and the Tax Department does not have a special treatment in term of bonus" (TM01). Another manager agreed with this statement. “There are several parameters used in our company for bonus arrangement” (TM12).

Another interviewee from a mining company expressed a similar opinion: that the bonus was not related to business profitability. Instead, the cash flow factor would determine the bonus amount. “Yes, at a certain level, the bonus was not associated with the profitability but rather to the operating cash flow” (TM10).

The other factors that influence the amount of bonus were the prearranged contracts between companies and their employees where the employees received a bonus amount according to a specific formula. In the case of the oil and gas company, a
government agency was also involved as an external supervisory entity assisting with the formula for the compensation. “In the oil and gas industry, the arrangement is a bit unique; all expenses must be approved by a committee (SKK Migas\textsuperscript{43}) including bonus. So, even though the company had satisfactory performance, the bonus payout must be approved by SKK Migas” (TM02).

Another manager from a pharmaceutical company pointed out that the function of the tax department in her company was frequently considered as only an additional function, and it made the issue of profitability unrelated to the bonus received, regardless of the magnitude of tax savings she made. “Tax and accounting are regarded as the supporting back office, the amount of bonus is unrelated to the profitability, unlike the marketing division that receiving bonus based on the percentage of sales” (TM09).

However, several managers refuted the argument for a strong connection between their bonus and the level of profitability, as voiced by a plantation company manager: “Indeed, there is a relationship between profitability and bonus, but it is not significant” (TM01). Meanwhile, another manager admitted that to some extent the company’s performance had a direct influence on the size of the annual bonus. “Yes, profitability did affect the bonus, only slightly for monthly income but not for the annual ones” (TM13).

Hence, given that in most companies a formula was applied when determining bonuses, tax managers of companies had no incentive for maximising the company’s profits by means of a tax scheme that would reduce their tax obligations. “Yes, we received a rise, but the amount is not significant. If the profit increased by a 100 percent, but our bonus rise is far from 100 percent” (TM05).

To conclude, many participants suggested that the issue of a manager’s bonus was not directly related to the businesses’ profitability performance; instead, the position of tax division as only the supporting part and the fact that there was a prearranged formula

\textsuperscript{43} The SKK Migas is a supervisory institution established by the Indonesian government. The Institution focuses on the management of upstream oil and gas business activities. The SKK Migas services includes State approvals for development plans, work programs, and budget, as well as to appointment of sellers of State oil and gas entitlements, and signing cooperation contracts
that determined the manager's bonus. This is an interesting finding since several of the studies mentioned in Chapter 3 have stated otherwise. The fact that the finding has different results with previous studies should be taken cautiously as many factors might affect the accuracy of interviewees’ response.

5.2.1.3 Detection probability and penalty

Another potential cost of non-compliance is the detection by the authorities of fraud, and the subsequent severe penalty that will be imposed. It is assumed that the possibility of detection and the heavy penalty for fraud will deter taxpayers from engaging in non-compliant behaviour. However, according to several tax advisors, many large corporations in Indonesia neglected tax as a crucial factor to be considered in their business operations and gave no thought to any possibility of being caught by the audit detection system. They realised that tax was a crucial consideration only after they had been audited and were stunned by the amount they were required to pay. A partner in a large tax firm confirmed that small and medium-sized businesses tended to have this problem. However, it also occurred in large businesses despite the fact that they had more substantial resources. “To some companies, tax is not a priority as long as they are safe from the penalties. At the time they were annoyed with penalties, felt the severity of it then tax became relevant, and they changed afterwards” (TA10).

Moreover, this negligence was evident when large businesses set up departments and personnel functions. The tax function was likely to be regarded as a menial job and was often the responsibility of the accounts department as just an additional task. As described by a senior tax advisor: "The factor of tax is not decisive when a company initiated a long-term investment in Indonesia" (TAo8).

Eventually, many large companies now are realising the importance of taxation. It means, they did not do it in the past. Tax section was only a small element in the accounting department, and even not a single person was appointed to be in charge to handle the tax matters. Until at the time when they got audited and, bam! ... They were hit by a massive assessment. (TAo6).
Interestingly, despite the potentially severe consequences of an unfavourable audit, large corporations seem to be unconcerned by some of the penalties imposed for non-compliance such as the fines for late tax returns. A manager in a large palm oil corporation explained this. “I consider this non-compliance as a minor, for example, if being late to lodge the VAT return then the penalty is IDR 500,000 (AUD 50) and two percent penalty per month for the underpayment. It is not such a big deal” (TM01).

Further, a senior advisor concurred with this manager’s view, arguing that the small penalty imposed for late lodgement of tax returns undermined their duty to lodge their tax returns promptly. He believed that the fines were too small to deter large businesses from non-complaint behaviour.

Some of tax penalties are not too heavy for the large-scale corporation. For example, the penalty of VAT late lodgement is only IDR 500 thousand (AUD50). It is ineffective to force them to comply. Therefore, if there is something more profitable, alternatively they prefer to pay the penalty because it is not significant. (TA13).

The abovementioned findings indicate that the severity of the audit results made the taxpayers realise the importance of taxation. The post-audit consequences have forced companies to change their views about taxation and make improvements in order to ensure compliance. However, in some large businesses, the factor of tax was not considered as critical for the MNC when making a long-term investment in Indonesia. As the underestimation of taxation was became an issue, this research also found that some of the penalties imposed were considered insignificant, particularly those for the late lodgement of either VAT returns or income tax returns. Moreover, several large businesses were not concerned about non-compliance as they were confident of the low probability that an audit would detect irregularities. Further, several participants argued that the seriousness of a large business in perceiving the importance of tax matters can be seen in their establishment of a tax function department in their organisation.
5.2.1.4 Risk appetite

Another factor that affects compliance is the level of a corporation’s risk appetite. Intuitively, the level of risk appetite plays a vital role in large business compliance. So, in order to obtain a comprehensive understanding of the taxpayers’ perceptions, participants were further asked their opinion about the propensity of a business to take more risks. Some advisors stated that the size of the business to some extent did encourage them to take more risks. If companies ingratiated themselves with people in the inner circles of government or influential government personnel, they were more likely to have a higher level of risk-taking. Conversely, those companies that tended to keep their distance from influential figures tended to have less risk-taking behaviour.

One partner stated: "Large taxpayers who lacked deep connection to the power centre, would thinking that their position is more vulnerable, they are facing higher tax risks" (TA01). Further, he observed that there was indeed a correlation between the size of a company and its connection to influential people, and this type of corporation was confident that given its closeness to influential people, somehow the tax risks would be manageable. “There is a possibility in Indonesia when corporations are getting larger, their status is getting closer to the power centre, and perhaps the issue of ignoring taxes is a kind of manageable risks” (TA01). Later, he gave an example of how a large business exerted its influence on the government by adopted a Corporate Social Responsibility (CSR) program or by the local customary approach, both of which at some point were regarded as being more important than their tax obligations. “The mining companies prioritise in doing a kind of services like the CSR, maintaining a good relationship to the authorities and so forth, but I do not see it with taxes” (TA01).

Given this typical connection between large businesses and high-ranking officials, it is unsurprising to find that some businesses can maintain their usual practices and survive despite being caught up in tax fraud cases. Moreover, another partner illustrated the behaviour of a disreputable business.

They have two reactions, to attack or to run. This type of company usually has strong connection with the government leaders such as the general or influential people in politics. Using their connection, in a way they strike back the DGT or they just run away or attempt
to negotiate under the table. It is actually happened even there is no evidence (TA09).

Interestingly, many of the participants who were advisors or tax officials noted that the large businesses had good overall compliance although the compliance generally referred to administrative compliance. In other words, regarding the punctuality of payment and lodgement, many large businesses did it in a timely manner. One tax auditor shared his experiences on this issue: "Particularly in the LTO1, most of the taxpayers are comply in term of reporting, and payment and it was what I saw during the examination" (TO02). Another official made a comparison between the large business and the small business; in his opinion, the large business had better administrative compliance.

The taxpayers in the LTO2 are more compliant than other taxpayers in other tax offices. Because most of the companies here are stable and have been established a long time ago and they know precisely the mechanism of taxation and how to administer their financial report accordingly (TO09).

Some advisors also agreed that in terms of administrative compliance, large businesses were more compliant. A senior tax advisor shared his experiences on this issue. “Our clients are mostly large taxpayers and foreign investment companies, and their administrative compliance was around 90 percent – 95 percent…. So, in terms of administrative compliance, they have a high-level of compliance” (TA05).

Meanwhile, another advisor responded that many large businesses complied to some degree not only in terms of administrative compliance but also regarding technical compliance: "For large companies, they complied with both technical and administrative compliance. The evidence is the insignificant audit findings" (TA12). On the other hand, he also suggested that the compliance level of large businesses is still debatable. However, in a more neutral tone, another advisor suggested that each large company has its own culture and level of risk-taking, and these factors did influence its compliance. “Some large companies are perhaps unethically doing overly aggressive tax planning, but some others conduct strict good governance for its tax matters, and it happens everywhere” (TA01).
The above findings demonstrate that the risk-taking of a company is affected by its size or by its closeness to the influential people in the country. Interestingly, there was a lower level of risk-taking when the company kept its distance from high-ranking officials. However, several participants assumed that large businesses had better administrative compliance compared to the small and medium-sized enterprises.

5.2.1.5 Uncertainty

In this section, uncertainty refers to the underlying economic model that in general guides people to make rational decisions in order to avoid uncertainty, particularly in regard to the things that are beyond their control. In this situation, the taxpayer tends to wait for enquiries from the authority, for example, in a matter concerning a specific transaction arrangement. Participants were asked about the risk of uncertainty in terms of regulations, as mentioned in subsection 5.3.2. One participant responded that he had to be extra cautious about the correct interpretation of the laws since this kind of situation occurred frequently and he preferred to wait for clarification from the DGT. “This thing made us extra careful in applying tax rules. Sometimes, the unknown risks made the company dealt with a high-risk exposure so, it is better just to wait for enquiries from the DGT.” (TMo4)

On a broader spectrum, the uncertainty that occurs in Indonesia was not caused only by the accuracy of legal interpretations or by the penalties, but also by the inconsistent application of laws and regulations by different tax officials in various regions.

I saw two or three coincidences that have made me not understand why there is no uniform treatment from tax office. When dealing with the officials in the regional area, they are so creative interfering our international transactions which not their authority. It happens because the guidance from the head office is unclear. It should be stopped. Otherwise, they become more creative in meddling beyond their authorities. (TMo4).

Taxpayers tend to comply and, yet some findings occurred because of misunderstanding or misperception of regulations by the officials despite taxpayers solidly understanding the laws as well as regulations. (TOo9).
To conclude, uncertainty occurs due to the inconsistent application of the laws and regulations by the tax officials. Hence, the taxpayer tended to wait for enquiries from the authority which, to some extent, could affect his/her overall compliance.

5.2.2 Socio-psychological aspects

Since the corporation is a unit that comprises a group of people, it is argued that human behaviour has a profound impact on the corporation, in particular on the work environment. Recent literature indicates that sociological and psychological elements significantly influence the decision about whether or not to comply, and to what extent (Koester, Shevlin, & Wangerin, 2014; Olsen & Stekelberg, 2015). This suggests that taxpayer actions are not driven solely by the cost-benefit factor.

Table 5-2 below indicates that the three socio-psychological elements that emerged from interviews were perceived as having a large and significant influence on large business compliance. The key informants perceived these elements as comprising personal norms, social norms, and fairness of and trust in government. It is acknowledged that the fairness of, and trust in, government are related to the other factor being considered in this thesis: the ambiguity of regulations as discussed in subsection 5.3.1.

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5.2.2.1 Individual- personal norms and social norms

The moral standards of a manager are a crucial factor that influences corporate tax compliance (Law & Mills, 2017). This standard is determined by the individual’s personal norms and by the internalisation of social norms (Wenzel, 2004). Moreover, personal norms can influence large business compliance since a corporation as an entity cannot decide whether to comply or not comply – this requires input from
managers. It is argued that the attitude of company managers has a significant impact on the business compliance as their standards and values play a part in their business activities and decision making. The characteristics of the people behind the corporation, according to some scholars, drive their business behaviour. Moreover, social norms could be attributed to the moral standards of the taxpayer community as a whole. Bobek et al. (2013) argued that social norms affect the compliance since they concern various influences that determine people’s activities, such as the norms or the values of family, ethnicity, religion or country, and these norms in turn may ensure that an individual act appropriately.

There were some interesting responses from participants regarding the behaviour of top management and their attitudes based on their origins or their cultures. Some interviewees also believed that the tax issue was still treated as a low priority. An official shared her thoughts on why a company failed to pay taxes.

They did not want to spend money on someone else, contributing to the country in which was not in their favour nor their interest. They think if they can avoid, evades or cheats; then the money can be poured into other business (TO04).

Meanwhile, a senior partner concurred that the characteristics of the person behind a company indeed influenced the level of compliance. These characteristics were those of ignorance and defiance both of which were shaped by an individual’s cultural background.

Well, I see the compliance not from the type of industry, but from the attitude of the persons who are there. From my experiences, there are two types of people for compliance. First, they do not intend to comply, they do not want to pay any taxes, and they do not care for the rules. Second, it is plainly because of ignorance (TA10).

The category of personal norms in this section is grouped based on ethnicity - those from a Western culture, and those from an Asian one, as they all inherit different values from their country of origin. In general, in terms of compliance, the westerners were regarded by participants as having a better compliance attitude than the Asians,
and the locals were regarded as the least compliant. One participant reasoned that his/her cultural background might shape the character of local individuals. "I think the system or the culture from their home-grown did influence on how they comply. It is based on my experiences that perhaps cultural factor did have the influence" (TA01). Moreover, another advisor suspected that, geographically, the origin of the people in management also had an influence on compliance.

Undoubtedly the culture has an influence, like the way doing their business. For example, Europeans or Americans are attached to a stricter rule than perhaps Asians who were seeing problem as “what is the easiest way instead of the proper way to solve this?” That makes the difference. The domestic perhaps try to follow the rules, but they are not as strict as their fellow westerners (TA03).

Meanwhile, another participant described his experiences of working with various clients from different backgrounds, and he was able to identify an attitude pattern based on his clients' nationalities.

In general, there is a behavioural pattern. The Americans are good in a sense that they consider that the law is imperative. The recent example is when we had a meeting last week for a case for appeal; we reconsidered if the case needed to go for appeal or not. My client said that the case should stay forward although they must pay later, the rules must be followed. However, for the Asians, it depends on what country they are coming from (TA09).

Further, another advisor also noticed similarities of character among his clients and believed that, in the Asian companies, the factor of tradition affected the attitude to comply, although profit-making was the priority.

The Asian companies, Japan, Korea and India, they have typical characteristics. It is a matter of tradition and behaviour. The culture of each origin has influence. However, after all, it comes down to the original issue, about profit, how to make a larger profit with fewer expenses (TA02).

It is worth noting that a sense of nationalism may affect the attitude of citizens as they do not want to deviate from what is accepted in their own country. In terms of tax
compliance, a senior auditor recounted his experiences with multiple overseas corporations. He observed that taxpayers from different countries had unique approaches regarding the issue of transfer pricing transactions.

Non-compliance comes in many forms, for example, transfer pricing. If we are dealing with the Japanese, the Korean, the Singaporean or the German, they are likely to withdraw as much profit as possible to their home country. In the past, transfer pricing issue was to minimise the amount of tax paid because tax is a cost. However, after observation, it is not only about how much tax that has been paid, it is also a matter of nationalism because their home country also heavily relies on tax revenue (TO05).

Further, several advisors and tax officials believed that the local people had the least awareness of their tax compliance obligations compared with their overseas counterparts. One advisor confirmed this: “It can be felt, but it is hard to prove, perhaps if the question is altered to what about the sense of nationalism, is it affecting local companies to be more compliant than its peers from overseas? The answer is ‘no’ (TA02).

Moreover, many of the respondents had had dealings with local companies, and the issue of non-compliance was familiar to them. One section-head official expressed his frustration with this defiant behaviour.

For the Indonesian MNCs, they are not paying taxes because of only tax avoidance but also committing evasion, they even cheated in the quantities, shamelessly creating fake expense account and it is inevitable. Setting up a new conduit company as a shelter even if the conduit has no underlying assets or economy. They really have a nerve (TO10).

He further mentioned that this defiance of local companies was tolerated or ignored because of their connections with high-profile individuals. Moreover, they had poor trust in the government and were somewhat indifferent to their business reputation.
It is common for the Indonesian businessman to be involved in the government. This will help them in terms of in managing tax dodging by unlawful moves, and they do it without any hesitation. Well, this kind of situation differs from the developed country where the law enforcement is stricter (TO10).

The responses of the participants showed a shared understanding that taxpayers’ attitudes influenced the extent to which their companies would comply. The cultural factor comprising thoughts, customs, beliefs and nationalities was regarded by several participants as a significant determinant of the personal norms, attitudes, and subsequent behaviour of managers when making tax-related decisions.

5.2.2.2 Corporate social norms- reputation

A distinct factor that separates individual norms and corporate norms in the research on corporate tax compliance is the reputation of the corporation, which is a major consideration that determines large business tax planning (Graham et al., 2013). Therefore, this section discusses the reputational issue for large business, and some valuable insights emerged when the issue of reputation was raised with participants. All participants agreed that reputation is a critical concern of large companies; however, according to participants, the lengths to which businesses are prepared to go in order to safeguard their reputation differ.

A tax director of a large consumer company expressed her opinion that the reputation of her corporation, which is a publicly listed company, is impeccable. “As a public company, reputation is everything. No doubt. So, we committed to maintaining our names and don’t be ever happened that we are just being well-known because of lacking compliance” (TMo6). Another manager maintained that the reputation of a multi-national company affects not only the parent company but its subsidiaries in Indonesia as well, and vice versa. “Reputation is fundamentally essential, especially for public listed companies. They will be very concerned when their reputation will potentially be spoiled when there is an issue with compliance” (TMo2).

A senior partner voiced his opinion that a multi-national corporation was more likely to maintain its excellent reputation, not only because it needs to keep it clean, but also
because of the external monitoring by non-governmental organisations (NGOs) who closely monitor MNC activities. “Usually the MNC has a well-known reputation, their reputation is more important than not paying taxes because of mechanism naming and shaming and also the NGO who is actively blasting large companies who pay no taxes” (TA04).

Further, large businesses feared that their reputation would be at stake if they were exposed to poor publicity. This is also another factor that constrains top management to comply with laws. As one tax manager stated: "Do not let it happen one day that this company appeared in the newspaper because of the unpaid tax arrears or even their directors cheated on tax. This is a large company. They maintain their reputation by complying with the law" (TM09).

When the participants were asked about the role of profitability and the reputation, the responses were varied. Some participants indicated that, in the long-run, maintaining a clear reputation carries more weight than the pursuit of a short-term profit. The manager of a plantation company gave this reason for his company choosing good reputation over profit: "We want to maintain our names and our track record because any damage to our reputation may disturb our activities in the future" (TM13).

Another manager emphasised the importance of the profit for her company because a business with profit is a business that survives. She stated: "Pursuing profit is important (for the company), the reputation could be ruled out if the profit is below expectation" (TM09). She argued that the principle of maintaining the company as a going concern will overrule everything that runs contrary to the principle of business sustainability. Another variation of this response came from a manager of a mining company for whom reputation and profit were two inseparable conditions. “Both reputation and profitability are vital. Reputation supports profitability in the context that reputation makes profit sustainable in the long run” (TM10).

As expressed by a tax consultant, businesses seek ways to maintain a balance between reputation and cost savings; although large businesses have their risk appetite, they are more logical than the average human being. "Business is always considering efficiency
like tax savings, but surely, they do not want to sacrifice their reputation, like do something against the law” (TA12).

The findings discussed above indicate that it is critical for large businesses to maintain their reputation, and large businesses fear reputation damage if their misconduct is exposed to public scrutiny. Meanwhile, on the issue of profitability, there was a different opinion among participants which is intriguing because as an entity that is more rational than the average person, a corporation’s compliance could be affected by an imbalance between concern for reputation and the company’s profitability.

5.2.2.3 Fairness and trust in government

The aspect of fairness is one of the most crucial factors that make a person willing to pay taxes and have trust in their government (Kirchler, Hoelzl, & Wahl, 2008). As mentioned previously, the behaviour of people behind a company determines the level of that company’s compliance. Hence, this section discusses how a perceived lack of fairness and a feeling of having been mistreated will to some extent affect the compliance behaviour. A senior tax advisor shared some of what he had experienced during a meeting with a client from a large company whose administration felt that horizontal equity44 and retributive justice45 were inappropriately applied by the authorities.

I met one of the chairmen of the Japanese company’s association, and I concluded that they were frustrated with the practices of taxation in Indonesia. In the long term, this will affect their behaviour to comply. It is either to discuss further of the problem, to fight or to cheat on it (TA11).

Meanwhile, lack of trust in government caused a company to be very cautious of being transparent in terms of disclosing information, instead of being incentivised; the openness initiative means more harm for a company. A senior manager of an oil and gas company explained why he preferred to keep his distance from authorities. He told

44 Goet (1978) argued that horizontal equity is the equal treatment of equally circumstanced taxpayers.
45 Walsh (2012) states that retributive justice is the perception that the tax authority is fair in applying punishments, even at the time when the rules are broken.
the interviewer that when asked by a superior executive from his head office in Tokyo why his company in Indonesia preferred a passive attitude towards tax administration, he “... explained to them that Indonesia had a different culture, if we were more overt then it is likely getting busted, being preyed upon” (TMo2).

To conclude, lack of trust and of the perception of being mistreated by the tax authority influence the compliance of large businesses. Some managers believed that greater openness could do more harm than good, and therefore there was no incentive to have greater transparency. Moreover, companies tend to lack trust in the government in general, not only in the tax authority.

5.2.3 Corporate characteristics

As an entity, a corporation has its own characteristics apart from those of the people who direct it. The behaviour of a corporation can be influenced by the quality of its internal control, its structure, and its relationship with external parties. Participants pointed out several aspects of internal control related to tax risk management that affect a business’ behaviour. Moreover, the corporate structure and whether it is a publicly listed or non-listed company and the ownership status also play a role in determining the level of compliance. Further, participants indicated that the use of external parties’ services and the profitability issue may also be regarded as factors influencing the compliance. Table 5-3 shows the factors that affect a large business’ compliance. The interviewees perceived these factors to be: tax risk management, corporate structure, use of the services of external parties, and profitability.

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TABLE 5-3 CORPORATE CHARACTERISTICS THEMES AND ITS SUB-THEMES
5.2.3.1 Tax risk management

One issue repeatedly emphasised by the participants was the quality of a company's internal control. Several tax managers believed that their internal control system was able to adequately handle any issue related to compliance. One taxpayer explained the system applied in his company regarding compliance.

We have individual guidance for either monthly or annual compliance. All procedures are followed, for example, tax withholding with its handbook. If there is any doubt or any discretion that should be made, there is a person in charge; there is a reviewer and all of it is facilitated with guidance and discretions, but if the problem is significant then I take it to the board (TMo6).

Another manager pointed out that by following his company's long-term goal, he could calculate the potential consequences of business risks.

We follow the long-term master plan as it must be implemented. Then, of course, we calculate the business risk. However, there will be a balance between long-term plans and the risk in short-term, and as the weigh-in was fit-in, then it will be decided upon the corporate action either to be executed or not (TM1o).

Further, he explained how he handled tax risk in his company by correctly balancing tax savings with the potential tax penalty that could be incurred following a particular transaction. “Tax risk is mainly coming from a transaction that we must manage from either business side or the taxation side. Both sides need to be covered. Never let any surprises happened such as unanticipated taxes” (TM1o).

Later, two most substantial tax risks were identified from the interviews: transfer pricing transactions and the volume of occurring transactions. Further, in detail, a manager in a plantation company pointed out transfer pricing transactions posed a higher risk since the DGT is escalating their attention on the appropriateness of such transactions. “We see that the largest tax exposure faced by the company is highly associated with transfer pricing because it refers to a related party and it is coincidental since our shareholder is our customer” (TM01).
From the other perspective, a manager in the banking industry stated that the sheer amount of transactions may potentially contribute to the failure to follow compliance. “The possibility of occurring tax risk is the error in the system due to the volume or the size of the transaction, so it is possible to generating errors” (TMo8).

Despite the confidence of tax managers that their system is sufficiently reliable to handle the compliance issue, several tax advisors had different opinions. Most of these advisors believed that the lack of a dedicated unit that specialised in managing taxes was part of a significant compliance issue for numerous large businesses. “There are not many that have such kind of system, although some few have set up a tax division with a segregation of duties such as who oversees complaints or planning” (TA14).

Another advisor agreed that the lack of a dedicated department for taxation purposes was also caused by the management’s attitude in underestimating the importance of tax in their company. “Only a few companies have their tax department in Indonesia as the others consider it as unimportant and insignificant. These companies are underestimating tax matters” (TAo8). She then pointed out that this ignorance might backfire. “I was surprised because such a large company did not have a tax department as they considered it as unimportant. They hired then a second-rate consultant to handle their tax matter which may result in significant mistakes” (TAo8).

Her opinion was supported by several other officials and advisors who saw that the role of the tax division was made negligible because of cost-saving considerations. This type of management viewed tax and accounting as being no more than a cost centre in the company, and they were likely to set up a tax division only if they could spare money from the budget, or they had to pay a huge number of fines or penalty because of their recklessness, as opined by a senior partner.

The company will not develop a tax department unless they got stung from the tax office. If they are never experience it, they feel that they are fine, no matter that a person concurrently does many jobs because of budget. I often see that an MNCs with trillion turnovers, but their tax people are only one or two (TAo4).
Later, this type of management often combined accounting and taxes under a single division, and sometimes an excessive workload was imposed on a single person. "Tax is only being attached to a minor section of the accounting department. Even, there is not any dedicated person who is specifically in charge of tax, but it is like additional works for the accounting staff" (TA06). Also, another advisor opined that the underestimation of potential tax risks might be related to the nature of the company, that is, whether it is local or multinational.

When they are a worldwide brand and have an established tax system then it is probable that a top-down approach will be adopted and the system established accordingly. However, for some companies with no global network then they manage taxes themselves, and still underdeveloped because they think that their tax risk is small, or they do not have resources (TA12).

Inadequate human resources in terms of experience and training is another factor that prevents companies from handling tax risk. One tax manager in the manufacturing industry admitted that he could not apply the tax risk protocol because of the lack of qualified staff. “We have started risk management since 2014, but there is no guidance we can apply because of difficulties like not everybody knows risk management” (TM05).

Meanwhile, many tax officials observed that even when large businesses have a reliable internal control system, in general, their internal financial control lack integration between accounting and taxes. As stated by one official, most of the internal control of the company that she dealt with is concerned with compliance only in accounting matters, not taxation. So, the internal control is more likely in place to evaluate business performance rather than to handle tax issues. Moreover, another official said that many large companies rely on monitoring from external sources such as the tax office to determine their compliance. Hence, the alignment of internal control with business policy might result in a deviation from the compliance standard based on the regulated laws.
The internal control is mostly reflecting the business operation if it is aligned with the corporate policy. So, the moral is complying with management decision than the tax laws. Further, this decision is affected by its tax morale that includes moral hazard, for example the corporate policy towards taxes could be unfavourable (TO12).

In recalling his own experiences, another official illustrated further the situation of several large companies’ internal control. “Most of the companies here, although they have sufficient internal control, they are still manually operated. Sometimes something misses happened. A manual system has vulnerability because of physical weakness or caused by human carelessness” (TO01).

Some large businesses are apparently aware that they have problems in terms of underqualified staff or lack of adequate staff to deal with complex taxation issues or some weaknesses of their internal control system. This is the point where they ask for assistance from external parties, and this is the time when tax advisors step in. As stated by a senior advisor; “Some large companies do not have internal control system related to taxes, but they are willing be reviewed annually” (TA11).

Another senior advisor further emphasised that sometimes taxpayers asked for a special session of compliance but not limited to tax matters. This additional session was considered as a complementary business approach for the purpose of compliance integration. “They have additional periodical compliance audit from their head office that complementing audit from internal control division. It covers many sides, for example, the pollution impact on the environment” (TA14).

Moreover, another advisor believed that the company’s internal control was the management’s responsibility to their stakeholders, indicating that management had established appropriate measures for handling business risk including tax risks.

Internal control will be a priority for the experienced large businesses. In the small business, priority for example, perhaps set on the turnover but for a large business the weigh is more on the control because of its huge responsibility. It is not only tax that matters but also the stakeholders (TA02).
However, some officials agreed that although the majority of large businesses had an adequate internal control, the factor of human resources shortage is a concern. A senior auditing supervisor described his experiences. “For the non-compliant companies, it depends on the management’s intention that it should be supported by sufficient human resources. Sometimes, no one oversees taxation in the company. It looks like that the job is like menial for them.” (TO21). He also commented that a specific type of business is more prone to non-compliance because of staff shortages. “This usually happens in the holding company. One or two employees are in charge not only for the holding but also for their subsidiaries. Consequently, the overload causes carelessness.” (TO21).

Interestingly, another official suspected that to some extent, the internal control of the holding company might become a vehicle for management to cover suspicious transactions in intra-company transactions. “It is like to makes sure that when there is accounting manipulation or tax dodging, then they have uniform treatment from the holding to their distant subsidiaries” (TO06).

Furthermore, when asked about the function of tax risk management, most participants admitted that, overall, the internal control of large businesses is better than that of the small or medium-sized businesses. The administrative compliance record such as timely reporting by big businesses is usually good. However, according to several participants, taxpayer’s commitment to comply was sometimes being hindered by cost-benefit concerns. In this case, a lack of human resources that should be dedicated to managing tax matters and the out-of-date tax management system may create problems. Another issue is related to the inter-company transaction that according to several advisors and officials that need particular attention.

For inter-corporate transactions in the global scope within groups where the company in Indonesia is only a small part of the global production chain, the risk of non-compliance is huge. I say huge because taxpayers realised that a single government only can not solve the issue of international transfer pricing thereby this situation might encourage them to do profit shifting. (TO20)
In conclusion, although tax risk management is regarded as vital to maintaining a corporation’s compliance, surprisingly, many large businesses did not have sufficient resources to support an adequate tax risk management function. The factors of cost-benefit-driven decisions and the underestimation of the importance of taxes were mentioned as the factors contributing to companies’ non-prioritisation of an adequate tax risk management function.

5.2.3.2 Ownership structure and business size

According to the participants’ responses, the structure of a company will affect its compliance. The term ‘structure’ in this section refers to the corporation’s ownership structure, that is, whether it is listed or non-listed, and the industry sector to which it belongs such as, for example, banking or mining.

Several participants perceived that, in general, listed companies have better compliance than the non-listed company. They observed that large businesses that were better regulated tended to be more adapted to the compliance requirements. A company that is required to report its activities periodically to the public wants its excellent reputation to be maintained. Further, a public company was viewed as having a moral obligation towards their various shareholders. A senior partner tax advisor stated that there is a compliance gap between a public and a non-public company. "From my experience when we handle both listed and the non-listed companies, we consider that the listed companies are more compliant. The reason is that they have more moral obligation and responsibilities to their stakeholders" (TA13). Another advisor added that the factor of reputation becomes a concern for a public company engaging in non-compliance.

It is obvious when the shares owned by the public; then it will hurt their reputation if they are not complying. However, for the non-listed company or the family business perhaps the point is you do not need to pay tax if you could apply tricks, and this is a primary difference (TAo7).

The factor of being well-regulated was mentioned by another tax advisor who believed that a tightly regulated business such as a banking corporation was considered to have
better compliance. "Listed companies are more compliant, because they are used to make reports to various institutions, not only to the tax office but also to the Otoritas Jasa Keuangan (OJK)\(^6\), so they are accustomed to that kind of compliance requirements" (TA12). His opinion was seconded by an official who saw that the rigid requirements demanded by government agencies contributed to company awareness about the compliance issue, unlike the situation in some local private companies. "When a sector is required to provide a more extensive disclosure and stricter reporting, then it has a better compliance. However, for the companies connected to the power then it would likely to have less compliance" (TO12).

However, the picture of listed companies was not always rosy; some participants argued that even though a listed company should meet tighter regulations, there were also issues on how those companies met their obligations. A senior advisor asserted that under certain circumstances, a listed company is not guaranteed to be free from compliance problems any more than its local family-owned counterpart. “The listed companies are more compliant because of their accountability, although we also experienced that our clients, the listed companies had issues with their tax obligation” (TA14).

Another advisor argued that not every family business tends to have lower compliance. "Once I handled a business family client, but they already had a good system" (TA05). Meanwhile, another advisor was rather sceptical that a listed company would be more compliant because of the possibility that the major shareholders expected their company to deliver profit by any means.

\[\text{It is not relevant because it can be seen from two sides. Suppose a company goes public then the shareholders demanding to minimise any cost and maximise profit. There is no certainty that a listed company is more compliant. It is true that being publicly listed means they are on the radar and delivers more good governance.}\]

\(^6\) Otoritas Jasa Keuangan (OJK) is the Indonesian Financial Services Authority that oversees the financial services industry. The OJK structure resembles that of the FSA in the United Kingdom. Like its counterpart, the OJK is a quasi-judicial body responsible for the regulation of the financial services industry in Indonesia. Its board is appointed by the MoF, although it operates independently of government and it is funded by fees charged to the financial services industry.
However, on the other hand, they have a larger responsibility to their shareholders (TA01).

However, many participants agreed that, overall, listed companies tend to have better compliance than the non-listed companies, although the details need to be scrutinised to determine the level of compliance of each business. One indicator of whether a business is ready to comply is their transparency which shows the intention of the management to meet the compliance requirements. As stated by one officer, "In general, the level of compliance depends on the company’s transparency type just like the listed company in which it is easier for collecting information rather than the closed private company" (TO03).

Several participants emphasised that the type of business could be an indicator of compliance because the nature of some businesses makes them more likely to be compliant. These participants gave the example of the banking industry and mining industry, where the latter was considered to have greater non-compliance issues. Some participants in the officials’ group argued that an industry that is heavily regulated tends to be more compliant. “Between mining and financial sector, the latter has a higher compliance because financial sector is supported by the requirement or being regulated where the supervision is very tight. Being well-regulated shapes their characters” (TO03).

Another official reasoned that the banking sector had better compliance than the mining because sometimes the latter did not lodge periodic tax returns even though the mining has made the payment. She continued that the factor of awareness distinguishes the level of compliance of both industries. “The banking sector is, on average, compliant because they concern about the taxation regulation and then they are proactively communicating with us as their Account Representative in case that any new rulings are issued. They also clarify to us first, when there are grey areas in the regulation” (TO07).

Apart from banking and mining industries, another official pointed out that the type of industry did make a difference in compliance level especially if an industry such as e-commerce has recently emerged. Such industries pose a more significant compliance
risk. “A particular industry is prone to non-compliance like e-commerce. It is a vulnerable industry as we do not know much about internet traffic and their turnover also has not been reported” (TOo4).

Meanwhile, a tax advisor claimed that in the matter of tax payment, the natural resources sector potentially had the most significant risk of non-compliance because they had to operate their business with several corrupted parties that required them to allocate more budgets.

The worst is when it comes to paying taxes is the mining sector and plantation... the company are involved in so many parties with a consequence that, so much money had been extorted under the table, so this surely makes the company unwilling to pay taxes because they have spent too much (TAo7).

The level of sophistication of the business structure should also be taken into account as a risk fact. As business grows, a multinational company needs to be involved in intercompany transactions more often. The transfer pricing method is usually applied by a business to perform such transactions. Regardless, the method is reasonably harmless if applied appropriately. However, several officials suspected that many large businesses had to exploit transfer pricing in order to minimise their apparent profit. One official pointed out that an affiliated company has the potential to be non-compliant more so than a non-affiliated company.

If a company has a more complex structure then they will have more intercompany transactions; it means a larger risk for the tax avoidance or the tax evasion. This is different with a single company, in which it does not have many affiliations, or it only has one or two affiliations that are relatively easy to be monitored by the tax office. Further, they do not have any transactions that are distorted by related parties. Thus, their transaction is based on the market operation. It is not like the affiliation transactions. Therefore, the more complex of the structure of the company is, the tendency is more not to comply. Hence, the more incompliant taxpayers are, the more opportunities for them to avoid more taxes (TOo1).
Another tax auditor agreed with this view that transfer pricing was problematic. He added that a larger business could be seen as an entity with larger resources.

By having overseas company and domestic companies make it easier to conduct financial engineering, avoiding the taxes. Large companies also have sophisticated resources to plot such as banking schemes, liabilities dodging or tax treaty shopping. The larger the company is then it is more likely to avoid taxes, or more likely to undercut their payment using their resources (TO08).

Another official gave an example of how a large business dodged its taxes. He shared his experiences that the most likely case of audit findings in his office were findings that related to transfer pricing manipulation, and it occurred in affiliated businesses that utilise tax havens, but it never occurred in a sole company. “The most straightforward indicator of transfer pricing problem is the net income. For example, a company which had a thin net income because the company had affiliated transactions in the tax haven countries or in the country where the treaties have many advantages” (TOo1).

The abovementioned findings indicate that factors such as the ownership structure and business size influence the compliance of large business. In general, the listed company is perceived to have better compliance than the non-listed company. Secondly, the business industries naturally have different compliance risk exposure. Thirdly, the multi-national companies that utilise tax havens were perceived to have a higher level of non-compliance.

5.2.3.3 Financial constraints

Several participants considered that financial constraints became a factor that influences corporate tax compliance. This is in the situation where a business is unable to meet its obligation to the government because of financial hardships or global financial crisis. An auditor shared his experience when a large business encountered a situation where it could not pay the overdue taxes. “There were some types of audit finding like the non-compliance caused by tax payment. Taxpayers knew the amount
to pay, no dispute about it. The problem was that taxpayer had shortage in cash flow to pay taxes” (TO20).

A tax manager from a mining company also stated that during the business hardships, it seemed tolerable to overlook any obligation in order to save the company from not being operationally intact. “Everybody is doing tightening in a business hardship, an aggressive efficiency to survive. That is the day of survival mode, waiting for the changes of situation. Options during the hardship are clear; employees are the last option” (TM07).

This was also confirmed by a high-ranking official who noticed that the non-compliance level increased if a company was facing a crisis. His responses confirmed what has been said by the mining tax manager above, that “non-compliance emerged when they encountered hardship in their business so that the tax matters would not be prioritised, especially with the tight cash flow” (TO03).

Secondly, business profitability here refers to a situation where the management prefers to do something other than paying corporate taxes. An official observed this occurrence at his office where a company preferred to not pay their taxes if they were short of cash. Another cause of not paying taxes was provided by another official who said that "Because of inefficiency in cash flow, the management delay tax payment with the reason of cash flow. They need to use the money; however, tax payment is not a priority” (TO06). The aspect of priority is also becoming an issue when management uses the money to pay tax or uses it for other business purposes. An advisor argued that those companies did not willingly decide not to comply; instead, it was impractical at the time because the company was forced by the situation to not prioritise tax payment.

To conclude, it was found that (1) the level of non-compliance is escalated when a business facing crisis utilises more aggressive tax planning to increase tax savings, (2) keeping the business operational becomes management’s priority rather than fulfilling their obligation to the government.
5.2.3.4 Use of a tax advisor

A business usually uses external auditors and external tax advisors as part of its governance mechanism to ensure that the business runs on the right path. Nevertheless, the roles of tax advisor to some extent are like a double-edged sword in that they can help taxpayers to reach full compliance by encouraging them to follow the law’s requirement and discouraging a reporting position that would be challenged by the authority. Alternatively, they can provide advice that exploits some features of the ambiguity in regulations with a taxation scheme such as the aggressive tax planning.

When asked about the role that tax advisors played and their relationship with their clients, some tax advisors argued that their job was mainly to assist taxpayers to meet their obligations or they played a role as reviewer of the actual taxpayer’s stance on specific cases. One advisor asserted that the multinational companies hired tax consultants because they wanted to ensure that their tax position was correct. “They hired us to ensure that there were no mistakes in their payment. Another reason is that they want to make sure that the tax rules have been interpreted correctly and they believe that tax consultant will deliver their expectation” (TA14).

Another advisor added that, mainly, the role of a tax advisor is to help taxpayers to comply with the applicable laws, but there is always a possibility that in Indonesia, that function can be extended to help taxpayers to streamline their tax burden if it is not violating the law. Further, he added that the goal of a tax advisor was likely to depend on the intention of his client. An official supported this advisor’s opinion, adding that the large business would want its tax advisor’s intention to be aligned with that of the company for matters including aggressive tax planning. “It depends whether encouragement of the aggressive tax planning was coming from the tax consultant. For a small or medium company, the action will be determined by the consultant’s behaviour, but for large companies, they do the action” (TO20).

In conclusion, the use of a tax advisor can have two opposing effects on corporate compliance. There is a positive influence on the corporate compliance if the advisor encourages the corporation to obey the law and avoid a position that might be
questioned by the tax authority. For example, by helping taxpayers to comply with applicable laws or to ensure that a tax position is correct under the law. Conversely, the influence is negative if the tax advisor seeks to exploit an ambiguity in the law or be compromised to follow the demand of their client.

5.2.4 Summary of corporate factor

This section presents a summary of the interview findings regarding the corporate factor. The themes in this section are arranged based on the factors that are frequently discussed in the literature of tax compliance, that is, the economic and the sociological factors. The themes are compared with the responses of the participants in regard to what they believed were the factors affecting compliance.

Regarding the corporate factor, the key informant participants were concerned that in terms of the economic factors, cost-benefit-driven decisions, manager bonuses, probability of detection and penalty, risk appetite and uncertainty were the crucial components of the corporate factor that influence compliance. Secondly, in terms of socio-psychological aspects, personal norms, social norms, fairness and comprises tax risk management, ownership structure and business size, business profitability and the use of a tax advisor.

5.3 Regulation factor

"The law is a profession of words" (Mellinkoff, 2004, p.vii). Despite all good intentions in the making of contracts, statutes and constitutions, the meanings of words are not always clear, precise and unequivocal; in fact, some words may lead to various interpretations by different parties. This multiple interpretation situation exacerbates the problem of regulation complexity that results in uncertainty. It relates to the circumstances when a taxpayer is uncertain about the consequences of his action because the law is lacking clarity so that taxpayer cannot predict the measure that will be taken by the enforcement institution.

The second issue is that of ambiguity in regulations leading to a lack of clarity regarding their interpretation and application (Schane, 2006). This issue of ambiguity
was strongly emphasised by participants as a critical factor that hindered taxpayers’ compliance. The third issue is regulatory overlap, which involves the problem of conflict, lack of coordination, complexity and duplication. The problem of regulatory overlap in Indonesia is severe because institutions lack coordination within and between them, which is a common occurrence in developing countries. The fourth issue is the unfairness in regulation where the design of the regulation is seen as giving more advantages to the tax authority (pro-DGT bias) than to taxpayers. Further, the regulation is treated more as an instrument ensuring the revenue stream, rather than having the function of addressing the problems in the society.

**TABLE 5-4 OVERVIEW OF REGULATION FACTOR THEMES**

<table>
<thead>
<tr>
<th>Compliance Drivers</th>
<th>Themes</th>
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<td>Regulation factor</td>
<td>Complexity in regulation</td>
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<td>Ambiguity in regulation</td>
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<td>Unfairness in regulation</td>
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<td>Regulatory overlap</td>
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</table>

Table 5-4 above shows the regulation factors that influence large business compliance. This table corresponds with themes and sub-themes that have been elaborated in Chapter 4. It is reiterated in this section to provide a clearer picture in terms of the regulations being a compliance driver.

**5.3.1 Complexity in regulation**

In this section, the complexity in regulations is related to the circumstances when a taxpayer becomes uncertain of the consequences of his action because the law is lacking clarity; hence, the taxpayer cannot predict the measure that the enforcement institution will take. Regulation certainty as recognised in the civil law tradition\(^{47}\) can be expressed as “a maximum predictability of officials’ behaviour” (Claes & Krolikowski, 2009, p.92). The issue of uncertainty arises when a regulation is drafted vaguely or ambiguously and when it has retrospective effect.

\(^{47}\) The law in Indonesia is principally based on a civil law system (the Roman Dutch law) intermixed with traditional customary law (*Hukum Adat*).
A tax advisor recalled his experiences when a new regulation was issued, and at the time, it raised a question for him on how to follow the regulation accordingly. He visited a high-rank official later to confirm. “The head of the regional office was said that he would provide a confirmation letter, but later he could not guarantee that the tax auditor or his successor would have a similar opinion with the content of the letter” (TA09).

The response from the official was therefore obviously causing the taxpayer to hesitate before proceeding further, and the absence of associated rulings was not improving the situation. Furthermore, a partner in a tax firm confirmed the possibility that the non-compliance level would increase because of the ambiguities in regulations. He added that the problem also stemmed from the unpredictable behaviour of the tax auditor even though he had managed the problem previously with the appointed Account Representative48 in the form of voluntary adjustment settlement before his clients lodged their tax return. It was not a guarantee that further adjustments would not be made. “Taxpayers tried to comply by managing their voluntary tax adjustment according to the law at their best, yet when audited they were being corrected on the adjustment, perhaps it might be better if the earlier adjustments were not made” (TA14).

At this point, this tax advisor hinted that making a voluntary tax adjustment did not protect a taxpayer from a future challenge by the authorities. Therefore, he questioned the requirement of adjusting the tax returns. “There is no need to make voluntary tax adjustments exactly as the law required because, in the end (in the audit), it will be re-corrected and be blamed as well” (TA14). Another example of uncertainty is that of a coal mining manager who dealt with tax auditors who were considered as acting out of line during the examination process.

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48 Account Representative (AR) is the official in the DGT who is assigned the task of, for example, handling taxpayer questions regarding the tax law.
49 Voluntary tax adjustments have no binding effect on the authorities. The DGT may still perform an audit and make additional adjustments plus impose a penalty although a taxpayer has made a voluntary adjustment and paid additional taxes accordingly (e.g., depreciation expense adjustments.)
We have seen the issues in the recent years, that the Contract of Works (CoW) which means a signed contract deal with the government and the taxpayer, still could be interpreted differently by the officials, so that afterwards, in the audit, they issued a bit unfair assessment. As the CoW has its privileges, it should not be intervened (TM12).

Disputes between taxpayers and the tax office sometimes recur; for example, in the case of transfer pricing, although the tax payer may win the case in a court of law, the same issue may surface during the next tax period. The participant added that this occurrence automatically raises questions from the stockholders, especially when it is a public company. “Well, it is disappointing when we appealed a transfer pricing dispute to the tax court, and we won. Nevertheless, the verdict cannot be referred as a base for the tax auditor to not creating corrections for a similar case in the following year” (TM12).

From the abovementioned findings, it can be concluded that the complexity in regulations resulted in the unpredictable behaviour of officials. Apart from the complexity and obscurity of regulations, the unpredictability was the result of inadequate expertise, loosely-applied standards and ineffective oversight by the tax authority, or a combination of all these factors. As a consequence, officials’ actions were often ad hoc and arbitrary. This unpredictability is a warning to the tax authority that there is a human resource problem in dealing with the regulation complexity. Hence, taxpayers face unpredictable treatment by officials, and further, may miss the fair opportunity to avoid penalty. Therefore, the issue of unpredictability will not be resolved until tight procedures and the clarity of standards are established by both substantive law and procedural law.

5.3.2 Ambiguity in regulation

Several officials, managers and advisors shared a similar opinion that the ambiguity in regulation plays a significant role in determining taxpayer’s compliance. A manager

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50 The Contract of Work has a feature of “lex specialis derogate legi generali”. This principle states that where two laws govern an analogous situation, then the law that governs a specific subject issue (lex specialis) overrides the general one.
even pointed out that one of the significant risks associated with compliance is the risk of failing to interpret regulations accurately. “One of the largest risks is the risk of interpreting the regulation. As the rule exists, there is always a risk of different interpretation between the tax office and us” (TMo7).

This opinion was echoed by another tax manager from the banking industry who shared his experience of a tax audit, ”The biggest correction component is caused by the difference of interpretation between the taxpayer and the tax office” (TMo8). This manager added that “The huge correction happened because of grey areas and differences in interpretation” (TMo8). The problem of multiple interpretations did not concern only the taxpayer, but also the two participant groups of tax advisors and tax officials who were recognised as experts in tax matters; they faced the delicate situation of transfer pricing transactions, for example. “It generates many debates because of the ambiguity in regulation. The government side has a different assumption. When the regulation was ambiguous then the assumptions took place. The royalty account is an example, theoretically it is deductible, but it was corrected with no reason” (TAo5).

A tax manager from a plantation company commented that even for a single regulation, there can be different interpretations by government agencies. He cited his experience about a governmental regulation on income tax facilities when his company tried to apply for that allowance.

As I recalled my experience, there was a point on the PP (Government regulation) No. 1, year 2007 which is superseded by the PP No. 62, year 2009 about the word of “integrated company”. The words itself have no definition, which causes multiple interpretations... if we look at the globalisation nowadays, yes, Toyota Japan and Toyota Indonesia are regarded as integrated. Another example, the General Motors, they manufactured the machine in Korea, chassis in Indonesia, spare-parts in Thailand; it is also integrated. However, because of the absence of definition then the effect is different interpretation among the government
agencies. From the standpoint of BKPM\textsuperscript{51}, Toyota is integrated. The DGT takes a position in the middle, it is integrated, but it must be by a single entity. The Ministry of Industry is even more amusing; it should be by a single entity and should stay in the same enclave. It looks like never ending case, so if you notice the income tax allowance regulation that has been decreed since 2007, only a few who applied and even fewer who had received the facilities (TMo1).

A couple of tax advisors proposed several reasons for the inconsistencies in the regulations. These are: a lack of historical knowledge, a too-general law, and a failure to choose an appropriate tax system. One partner who is also a keen observer of the tax system in Indonesia argued that the regulation-making process is unable to deliver a proper regulation. “Many regulations were made with the gap of lacking historical knowledge, so the taxpayer or the agent who knows the paradigm of the old rules sometimes feeling that there is a disparity, inequality which result in dispute” (TA\textsubscript{1}). Consequently, it is reasonable that “Current regulations are more prone to multi-interpretation” (TA\textsubscript{1}). Meanwhile, another director from a high-ranking tax firm in Indonesia asserted that the tax laws created plenty of loopholes because they lacked sufficient detail.

Our regulation is too general, so it leaves many interpretations in the field. The interpretation is made by the officials then. In general, if we compare it with the US regulation, even Australia’s and the Europe’s, their regulation is more detail (TA\textsubscript{03}).

The inadequacy of detail as mentioned by TA\textsubscript{03} was also supported by another tax firm partner, who said that this would open the possibility of bias at the lower level of regulation. Furthermore, an inappropriate delegation of authority might result in the abuse of power.

Talking about procedural, the IRS has a thicker book for tax laws, compared to ours which is thin and many things are being delegated to the regulation at the lower level. This opens precedence by the laws to other ways than those in which governed

\textsuperscript{51} BKPM is the Indonesian Investment Coordinating Board, an agency that manages foreign direct investment or domestic direct investment in Indonesia: See \url{http://www.bkpm.go.id/} for more information.
itself. However, currently the interpretation now tends more to revenue target and to the ad hoc mechanism (TA01).

On the side of the taxpayer, one thing is obvious: the misinterpretation is a burden. Asking advice from a tax practitioner is not a guarantee that the issue will be clarified. One tax manager from the mining sector illustrated this with his comment about the effect of an ambiguous regulation.

The problem is the existing regulation can be interpreted differently, by the tax office and by us. It results in excessive costs. To ensure the meaning of a regulation if I think that tax office has a different interpretation, I need the opinion from a tax advisor. That is a cost. Even, if I hire the advisor then, it may raise a dispute. Resolving the dispute needs time and money. This high-cost economy is a burden to the taxpayer, an encumbrance, as if there is no certainty and this is causing discouragement for people to comply (TM07).

Meanwhile, the interviews with tax officials revealed that the officials are not unaware of the issue of multiple interpretations. In fact, one tax auditor encountered complications on how to impose a particular regulation correctly given the dynamic of the rules changes; he implied in the interview that the ‘back-up’ provided by the related technical directorate was as inadequate. Further, the head of one LTO office commented that a different interpretation posed an actual risk for a multinational company. He said, “The famous large MNCs, usually they were (perceived as) non-compliant when they think that the regulation induces to multiple interpretations, because they had been wrongly interpreting the rules then it seems that they are not complying” (TO03). Nevertheless, some officials viewed this as only a stance on a particular regulation which gives either taxpayer or tax office the grounds for defending their position. This stance is affirmed by Freedman (2010) who stated that there are always grey areas where the tax authority is confident that its position is supported by the law. Meanwhile, the taxpayer takes the opposite position but with the same confidence.

The major issue is related to some reporting, for example, there are some taxpayers' standpoint that not allowed by existing regulation. Meanwhile, the taxpayers have their views about aspects related to
the contract, and they felt that they had followed the regulation while on our side, it was not followed, and this often resulted in dispute (TO11).

Regulation acts as the foundation for every action conducted by the tax officer. The problem is that many things in regulation are still in 'the grey areas'. Each party, either tax office or the taxpayer has a different position in addressing this 'grey area' (TO01).

It becomes evident that every group of the participant were agreed that the ambiguity in regulation could create multiple interpretations. The result of this ambiguity does not only create disputes between the taxpayer and the tax office but also among government institutions. A tax manager was confident that a significant reduction in regulation ambiguity would lead to compliance improvement.

However, sometimes, people do not comply because the regulation is unclear. Moreover, that kind of interpretation differences should be significantly reduced. So, the taxpayer would be happy because the rules are absolute, no ambiguity, no grey area. It will increase compliance rate (TMo8).

Therefore, ambiguity in regulations is apparently a vital issue that needs to be rectified. The different possible interpretations confused the taxpayers and increased the likelihood that they would not comply with the laws. Moreover, the misinterpretation created extra costs for taxpayers who need to hire external tax professionals to clarify their position. Ambiguity in regulations makes the tax authority less accurate when executing what is required by the law. The issue of multiple interpretations creates conflicts among government agencies as well as more disputes with taxpayers.

5.3.3 Unfairness in regulation

During the interview, several taxpayers and tax advisors complained that when making a regulation, the DGT distorted it to better accommodate its own interest, that is, achieving its tax revenue targets. The regulation was therefore pro-DGT biased. A partner in a tax firm was questioning the neutrality of tax regulations: “The regulations which are issued are likely about the budgetary issue, to collect more money rather than to regulate a specific subject” (TA01). Another partner asserted that the bias in
regulations caused disputes because it is contrary to the taxation principle. “Our tax provision is focused on the revenue targets, so many tax regulations deviate from the fundamental theories of taxation. Well, this is occasionally causing disputes” (TA13).

Moreover, from the taxpayer's perspective, it was not unusual for the DGT to take actions outside the law not only in practice but in regulation-making as well, disregarding the fairness principle.

On the one hand, indeed that the regulations are complex in Indonesia, on the contrary; honestly, I say that the DGT as a regulator is inconsistent in applying the law. Often the DGT creates legal breaches or even we may call it a legal abuse. Now, the goal is the State account oriented only, to meet their revenue target (TM01).

As said by another tax manager, the neutrality of the DGT in terms of the taxpayer was questioned. For example, when dealing with a regulation that has ambiguity, instead of providing an equitable solution, the DGT frequently took a pre-determined position before the solution was offered. For example, an oil and gas tax manager sensed that officials often take a position which is unfavourable to the taxpayers regarding an ambiguous regulation. “If there are any differences in interpretation like I said (before) about grey areas, it is likely that the DGT (stance) would take side with the tax (revenue) targets” (TM06).

To conclude, the findings of this subsection show that unfairness in regulation influences the compliance of taxpayers. If a regulation contains a pro-DGT bias, it will negatively influence the taxpayer's trust. Ideally, a regulation should be neutral, and accommodates the interest of both parties: the tax authority and the taxpayer.

5.3.4 Regulatory overlap

In this section, we discuss the issue of regulatory overlap which many participants saw as an important factor influencing large business compliance. Firstly, the problem of overlapping regulations, it was a common hurdle experienced by taxpayers. For example, the inconsistency between the governmental regulations and their associated laws was not only an issue which occurred in one particular field; in fact, the
inconsistency occurred vertically at every level of the law’s hierarchical order, from the law passed at the top to the decrees issued by the DGT as the lowest regulatory body. A director of tax practitioners from a Tier 1 tax firm shared his opinion on this issue.

Sometimes when we analyse, the tax law states this, but the MoF decrees states differently, the Ministry of Energy and Mineral Resources decrees says far more. Which one then should we comply with? If we refer to a DGT’s circular letter, this is the DGT stance towards the existing regulation. But this letter conflicted or different with its related regulation, so what should we adhere to? (TA09).

Overlapping of regulations is not uncommon, and conflict occurs because regulations state different things in regard to the same issue. Moreover, a regulation might not be valid if it regulates beyond its mandated authority. One tax manager for mining companies gave a clearer picture in the following statement:

An example is The Governmental Regulation (PP) Number 74. The law states that the Notice of Tax Assessment (SKP) is issued only by the tax auditor or data novum52, surprisingly that the PP No. 74 states that the SKP also can be issued by other people than the auditor. No such things are regulated in the law, this is deviating and causing uncertainty, this is very dangerous for taxpayers. (TMo6)

One tax advisor confirmed the tax manager’s opinion regarding problematic regulations, stating:

Frankly speaking, the current regulations are causing more confusion and even chaos. One example is PP Number 74 Year 2011, primarily related to the article about interest compensations, in which according to the practitioners and the taxpayers is deviated from the norms that have been set up in the law of KUP53. My colleagues also share the same opinion. It is not about the language in the regulation that is confusing, but this is just inconsistent with the norms of the legislation (TA14).

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52 Data novum is a legal term in Indonesia referring to new data that emerged after a legal process has been completed or decided.
53 The KUP is the other names of The Law of General Provisions and Taxation Procedures (Law Number 6 of 1983).
The information above gives some examples of how tax regulations may contradict each other, and not only in regard to taxation. The problem of overlap also occurs between the taxes regulations and the regulations pertaining to other institutions. Several tax advisors and taxpayers complained of this situation that existed, for example, between the DGT and other agencies or between the central bank and the OJK. The overlap issue also applied to the accounting standards. A consumer goods manager mentioned that the risk of overlap was an external risk beyond her control. “There is a regulation overlap between the OJK and the taxation. It creates compliance risks for us. I can contain the internal risks but not the external risks” (TM04). Another manager pointed out the issue of conflicting regulations between the tax and the accounting standards, resulting in headaches for taxpayers, not only because of the contradiction but also because of the poor quality of the regulations which made them hard to follow. “Many regulations were issued which even contradicted with other regulation, for example, some regulations are conflicted with the PSAK54. Then, when it has been regulated, it is causing dilemma to the taxpayer” (TM01).

The overlapping forced taxpayers to carefully prioritise the rules that need to be followed and, in many cases, the tax regulation was not prioritised. A tax auditor recounted his experiences when his team examined several banking corporations.

The type of findings that we found in the banking is findings mostly caused by the differences in compliance requirements between the DGT and the Central Bank. The taxpayers missed the requirements from the DGT because they prefer to comply with the Central Bank (TO17).

Meanwhile, the conflicting regulations also exist as in the case of the tax audit of mining companies. It was common for the resultant findings to not be accepted by the audited taxpayer because this entity’s works were based on a Contract of Work (CoW) instead of the tax auditor references, the prevailing laws. “The findings are always caused by the disagreements of the CoW for the taxpayers in mining (industries). Which law should be used, the general laws or the nailed down contracts?” (TO17).

54 PSAK is the Indonesian version of general accepted accounting principles (GAAP). The GAAP consists of a collection of commonly-followed accounting standards and rules for financial reporting. It is a combination of standards set by a policy boards and the accepted ways of recording and reporting accounting information. A company must follow GAAP when they arrange their financial statements.
Often, the differences resulted in dispute between the taxpayers and the tax office with the final settlement being decided in the courts where most of the time the verdict favoured the taxpayers. Consequently, the government had a double defeat, losing the case and having to pay compensation to the taxpayer.

The second type of overlap problem is the issue of poor coordination. It is no secret that a lack of coordination among institutions is pervasive in Indonesia. It has been longstanding practice in Indonesia for many agencies to operate in isolation with their main concern being their own interests. Even the regular coordination meetings are frequently nothing but a formality. The statement below confirms the coordination problem between two ministerial departments that resulted in regulation loopholes and created confusion for the taxpayers.

It is not because we do not want to comply but because the regulation cannot be applied, it is non-synchronous. I give you an example, the reclamation cost; it is a tax deductible with some approvals. Getting approval from the ESDM\(^{55}\), no problem, because it is regulated there, but approval from the DGT? We seek all procedures, no DGT’s regulation for such thing. So, how could we claim this reclamation cost then? (TAo9).

The loopholes in the regulations give taxpayers the opportunity to choose which regulation to follow although it may result in a higher compliance cost. In other words, there were risks and opportunities, in terms of either an increase of tax savings because of non-detection or greater expenses because of the imposed sanctions.

The current example is we are enforcing compliance with the cost of PPAP write-off\(^{56}\). Inside this cost, perhaps there are promotional expenses that we require them to adhere to the filling of a nominative list of the taxpayer identification number (TIN). Well, they did not fill it because they argued that that thing not required by the Central Bank rules, so they hold that stance (TOt5).

\(^{55}\) The ESDM is The Ministry of Energy and Mineral Resources of Indonesia.

\(^{56}\) The PPAP is the provision for loan losses in banking industry. It is a set-up allowance in the bank to cover potential loan losses, for example, bad debts or customer defaults.
Another example of a loophole concerns the accounting standards. Since the full adoption of the International Financial Reporting Standards (IFRS) in 2012 by the Institute of Indonesia Chartered Accountants (the official accountant profession in Indonesia), the gap between tax accounting regulations and the GAAP has widened in regard to what needs to be regulated. According to Mulyadi et al. (2012), there was no regulation or adjustment made in response to the IFRS. “The IFRS arrangement has many divergences with the tax rules. Perhaps the tax rules with the applied GAAP is relatively convergent, maybe about 95 percent is converging already. However, in terms of the IFRS, none of the tax legislation to date has accommodated the IFRS arrangement\(^{57}\) (TO01).

The lapse between Mulyadi et al.’s (2012) publication and the time of interviews in 2015 indicated that the authority was unprepared to anticipate the dynamics of business; in this case, it is an example of regulatory overlap that occurs between tax regulation and the accounting standards.

Thus, it can be concluded from the findings that regulatory overlap creates a waste of resources and occurs because of the inconsistency among the laws that having overlap rules regarding similar issues. The inconsistency occurs either vertically with its sub-regulations or horizontally with the other laws. Secondly, it occurs because there is poor coordination among agencies. Therefore, these findings confirmed Aagaard’s (2011) assertion that regulatory overlap is caused by the existing conflicts, redundant duplications, lack of coordination, and unnecessary complexities.

5.3.5 Summary of regulation factor

This section presents the summary of the analysis from the interviews as presented in Section 5.2, the regulation factor. The themes emerged based on the perspective of the participants regarding the issues that they considered were the most essential in influencing compliance. It is worth noting that many participants from three groups

\(^{57}\) GAAP or generally accepted accounting principles is collection of commonly-followed accounting principles, standards and procedures for financial reporting.

IFRS or International Financial Reporting Standards is a set of accounting standards in which developed by the International Accounting Standards Boards (IASB).
(tax officials, tax managers and tax advisors) considered that weaknesses in the regulations are a significant factor that affects compliance. The ambiguity and uncertainty contained in regulations, regulatory overlap, and unfairness in regulations are the main issues discussed in section 5.2. Section 5.3 dealt with the corporate factor, considered by many participants as having a significant and sometimes vital influence on large businesses’ tax compliance in Indonesia.

5.4 Chapter summary

This chapter discussed the findings of this thesis to answer the first research question: *What are the factors that influence large business taxpayers’ compliance risks from the perspectives of the tax officials, the tax managers, and the independent tax advisors?* The research question was addressed by interviewing 48 participants in total which were grouped separately according to their job function: tax manager, tax official or tax advisor. The inclusion of a variety of parties as key informants was done to provide a broader and richer perspective of the topics under discussion during the interviews.

The findings showed that many participants considered that the improvement of regulations is one issue that requires serious and immediate attention. Authorities have been alerted to the shortcomings in the legislation that need to be addressed in order to improve the level of compliance. The flaws that must be tackled include the ambiguity and unfairness in regulations, uncertainty, and regulatory overlap. Furthermore, the findings showed that many participants believed that the economic factors, sociological aspects and corporate characteristics also influence large businesses compliance. The participants believed that some improvements to corporate characteristics would contribute to better compliance behaviour. In this regard, the authority’s direct interference is needed to create a supporting compliance atmosphere for a business to behave as required. Factors such as probability of detection, penalties, perception of fairness, and trust in government are some that can be addressed immediately by the government in order to create better compliance. Other considerations such as cost-benefit driven decisions, personal norms, social norms and ownership structure are features of corporations that need to be carefully monitored in anticipation of potential defiant behaviour.
6.1. Introduction

The previous chapter elaborated on the findings related to the first research question of this thesis, that is, the factors that influence the Indonesian large business non-compliance risks from the perspectives of tax officials, tax advisors, and tax managers. This chapter elaborates on and discusses the second research questions of the thesis: How does the tax authority manage large business taxpayers’ compliance risks according to the factors identified by addressing the previous research question?

Section 6.2 discusses the DGT's current capacity to respond which hinders compliance, an issue that requires the authority to manage non-compliance. This section examines three fundamental issues that prevent the DGT from functioning efficiently. These issues are human resources (6.2.1), data access (6.2.2), and administration (6.2.3). Section 6.3 discusses how the DGT manages the issue of non-compliance. Section 6.4 presents the opinions of the participants regarding responsive regulation as a solution to deal with non-compliance. Section 6.5 summarizes and concludes the chapter.

6.2 The DGT’s current capacity to respond

Prior to addressing the second research question stated in Section 6.1, it is essential to acknowledge the challenges encountered by the revenue institutions. This requires obtaining a thorough overview of the management of non-compliance by the institution because the problems of non-compliance exist in all countries regardless of the way it is manifested. Unfortunately, tax authorities in developing countries face more considerable challenges when compared to their counterparts in developed countries as pointed out by Baurer (2005)\textsuperscript{58}, and Indonesia apparently is no exception.

\textsuperscript{58} See Chapter 3 Section 3.6 for detailed information.
Regardless of the administrative reform that has been undertaken by the DGT in the last sixteen years, still, there are three issues identified by participants as the factors that prevent the institution from effectively managing large business compliance risks. Table 6-1 shows three significant themes associated with the issue of institutional capacity. The issues of human resources, poor data management and poor internal coordination were significant contributing causes of non-compliance that were noted by interviewees.

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<th>Drivers</th>
<th>Themes</th>
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<td>The institutional capacity</td>
<td>Human resources issue</td>
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<td>Poor data management</td>
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<td>Poor internal coordination</td>
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TABLE 6-1 OVERVIEW OF THE DGT’S CURRENT CAPACITY TO RESPOND AND ITS THEMES

6.2.1 Human resources issue

6.2.1.1 Integrity and corruption

Many taxpayers and tax advisors admitted that since the administration reform launched in 2002 known as the DGT’s Modernisation, the positive result such as the employees having greater integrity and being less corrupt indicated that reform was on its way. Even so, corruption has not been entirely eradicated. An advisor compared the situation before and after the commencement of modernisation. “Since the modernisation commenced, the corruptive behaviour is significantly declined. It is very different now than years ago before modernisation, but the fact is, there will always be crooks” (TA04).

Another advisor even praised the current integrity situation, and she emphasised that the factor of lacking integrity happens elsewhere. “I am not too disturbed by their integrities, only one or two crooks are out there, and I do not want to be unfair and generalise my perception about the DGT because of them. It depends on each officer’s own moral standard” (TA08).
A tax manager also testified to the changes that occurred in the DGT. “At the moment, the corrupt officers are not as many as before, but they still exist.” (TM09). Moreover, regarding those few who were alleged to be corrupt officials, some tax advisors suspected that tax auditors were at the top of the list.

In the last five years, the phenomenon of corruption that committed by tax officials still exists although, regarding quantity, those illegal actions were declining. Most likely, tax auditors are suspected as the culprit of this misbehaviour (TAo6).

However, many tax advisors also believed that the current officers feel a stronger sense of embarrassment, for example, if they were acting inappropriately by, for example, asking the taxpayer for a bribe. Interestingly, despite the progress that has been made in administrative reform regarding integrity improvement, two participants, a taxpayer and a tax advisor, believed that the professional quality has deteriorated. “I believe the current tax officers have more integrity. It is much better than five years ago. However, it does not mean that by having higher integrity then whatever they do is correct. That is a different issue.” (TA13).

From the above findings, it can be concluded that the overall integrity is currently better than that in the era of pra-modernisation although some corrupt officials are still in the organisation, and it has a negative impact on compliance. The interviewee data indicated that professionalism of officials has also declined. The reason for this decline in the professionalism of DGT officials is discussed in the following sub-section.

6.2.1.2 Lack of professionalism

The decline of the tax officials' professionalism had been noted by several taxpayers and tax advisors. At least three attitude issues are involved here: too afraid to decide, abuse of power and a biased interpretation of the law. An advisor stated that “The strange thing is when the integrity is getting better, yet their professionalism decreased because they were too afraid to make mistakes” (TA01). Another advisor pointed out that the problem was not only about making a decision but also the issue of shifting their actual responsibility to other parties. “Now the officers are too afraid
to take a decision. They tend to shift their problem to somebody else, and this is unhealthy circumstances.” (TA11).

Several taxpayers and tax advisors noticed that some officers also had issues with their responsibility. They suspected that some officers abused their power to achieve their aims. One tax manager felt that the auditor was more untrustworthy than the other personnel in the workplace such as the Account Representative (AR).

There are two different views on this. First, the AR already had excellent service in the session of regulation dissemination. They invited us, and we had plenty discussions there. On the other hand, at the time of the audit, I saw no cooperative attitude; the auditor was more like abusing their power. We had to do whatever they said. What I want to say is dealing with the auditor is entirely different (TM04).

Another senior advisor shared his experience that sometimes the threat to audit had been used by some officers to intimidate taxpayer to follow their intention instead of working through a constructive discussion.

They said, ‘If you do not lodge the revised returns immediately, we will audit you, the instruction letter to audit is ready’. The point is they were intimidating rather than persuading us into the discussion which is more preferable. I can make my client pay taxes by that discussion, but instead, sometimes the threat just happened (TA04).

Along with the abuse of power, the less-than-professional behaviour of the auditor also led to bias concerning the interpretation of laws and regulations. The tax manager of an international bank described his experience when his company was audited. “The rules are clear, but they confused us with the intriguing process. Perhaps if the rules are unclear, in the grey area, then it would be understandable, but in this case, the rules are clear. They just made it up, and they lost our respect eventually because they were unfair” (TMo8).

Another tax manager also shared his concern on this matter that the auditors’ competence in interpreting laws requires immediate improvement, and he added that
the custom of having adjustments made by the auditor, regardless of the effort by the taxpayer in following the rules, was somewhat misplaced. “There is no problem with their integrity. The problem is lack of professionalism. For example, the auditor must produce corrections. So, some corrections were forced to be there; they made it up” (TM13).

Many participants were aware that the lack of professional attitude is likely not inherent to the officials’ behaviour but arises from external pressure. Several tax advisors and taxpayers pointed out that the revenue target was probably the primary cause of the poor professionalism of officials. Tax auditors regarded the revenue target that was imposed on officials as a burden created by misguided policy applied by the DGT’s top level management.

If an auditor was not burdened with the revenue target as an indicator of his/her performance, then he could focus on his job professionally, following his intellectuality, his knowledgeability and that is what distinguishes between the professional auditors from the rest (TA06).

The auditors were not unaware of this target burden. However, it seems that they were powerless to refuse the massive pressure from the office that determined their career path. As stated by one advisor, “If you were talking with an auditor from the heart, s/he will say that it should not happen, but because of the pressure, then s/he just shrugged and let you appeal his/her audit” (TA11).

The short-term interest to meet the revenue target by utilising all possible means to achieve the tax authority’s goals created confusion and uncertainty among taxpayers and deviated from the real purpose of the audit itself. “Regarding the tax revenue target, the tax audit becomes a tool to collect additional money instead of a tool to test taxpayer compliance. It is a contradiction; testing compliance means if there is any indication of non-compliance then it will be reflected in the Notice of Tax Assessment issuance” (TA14).

Several participants claimed that as a consequence of this pressure, the quality of some audit findings was unreliable. The auditors were aware of this situation, but they preferred to remain indifferent. “They admitted that they were burdened with those
revenue target pressure. Even, when it makes them indifferent as long as their mission is completed, they did not care whether it was right or wrong.” (TA13). Some tax managers even took some audit findings less seriously.

In the past, the audit assessment brought us goosebumps because it was tough to take responsibility for it in front of the BOD. They would ask, ‘Why don't you mitigate those risks?’ However, at the moment, although the audit assessment was significant, we were a bit relaxed because those corrections were not robust. It means the assessment in the past is more qualified (TM06).

Another tax manager gave the evidence of the low-quality audit findings produced by tax auditors. He pointed out that taxpayers had won many cases in the tax court concerning the dispute between the taxpayer and the authority because of such findings. In addition, the low-quality findings would divert the already limited resources of the DGT to pointless battles in the court.

When the budget target is set too high, then there are excessive attempts than it should be in the field, like the unnecessary audit findings that happened because the auditor had the pressure to meet revenue target. The findings sometimes were quite significant in numbers even though most of them ruled out by the tax court. It seems that the DGT is not optimal to utilise their resources because they spent so much time in the tax court for those invalid assessment (TM10).

In conclusion, the participants believed that the lack of professionalism was due to three contributing factors: the abuse of power, a biased interpretation of the law, and the pressure of having to meet the revenue target. The combination of these three factors was perceived by participants as a critical issue that should be rectified by the DGT.

**6.2.1.3 Lack of adequate human resources**

Another issue influencing the effectiveness and efficiency of the DGT is its lack of adequate human resources. The term ‘adequate’ in this subsection is related to the number of personnel, their overall competence and their management. As asserted by Baurer (2005), the imbalance between the organisation’s requirements and the
situation of personnel is a classic problem of the tax authority in developing countries. Some high-ranking officials recognised that compared to the large businesses’ employees, overall, the DGT personnel were considered not only as less competent than their counterparts in the private sector, but also lacking in number.

We lack resources to enforce the law, not only about the quantity but also the quality. We are behind in terms of aggressive tax planning knowledgeability. Therefore, perhaps we caught the perpetrator in the two or three years after the event happened if only, we can detect the violation (TO12).

Moreover, he continued that because of this lack of competence, it was difficult for the tax authority to apprehend the actual scale of large business compliance. Another official gave an example of a competency that a large taxpayer office should have: the skills required for transfer pricing.

With regards to transfer pricing, unfortunately, our human resources are less knowledgeable. Even with much training, still many were reluctant to apply it because of its complexities. Transfer pricing is not as simple as depreciation calculation or other simple accounting transactions. Transfer pricing deals with accounting, comparison, and sophisticated analysis. Not everybody wants to do it even whenever he has the skills (TO01).

Regarding the issue of incompetence, some tax auditors posted at the Large Taxpayer Office admitted in the interview that they could not detect an attempted violation by taxpayers during the course of their work. “I never find it, and I do not know how to handle it because I never find it” (TO09). Another tax auditor gave a similar response although his statement did not reflect the typical situation.59 “In case of tax avoidance or tax planning, I never find it because those we audit mainly are mining companies in this office, the methods like transfer pricing are uncommon” (TO02).

Another issue of the administration function is the poor human resource management even though most of the newly-recruited officials were regarded as the best possible

59 Many cases show that the practice of transfer pricing abuse is common in the mining industry and even a team from The World Bank issued a specific guidance about it. “Transfer Pricing in Mining with a Focus on Africa: A Reference Guide for Practitioners.” (2017).
resource compared to those in other government agencies. A tax manager who previously worked at the DGT gave his opinion of this phenomenon. “The problem is the career system management within the DGT although many employees that were recruited were initially, really qualified. The current system cannot empower the employees to be ready for any future assignment. Moreover, the system fails to ensure personnel's capabilities” (TM07).

This manager’s statement confirmed Baurer’s (2005) claim that the absence of a promotional merit system based on a professional evaluation, and the political interference in personnel promotion, robbed several employees of any enthusiasm for their work. Further, one official observed that the poor competence of an auditor might be caused by the irregular pattern of the auditor rotation system without respect to specialisation. He then compared his colleague's capability with that of a large business' employee.

Tax managers mastered their tax matter because it is their speciality. It is a different situation with the tax auditor who needs to handle various industries. It can be banking this time, mining another time, heavy equipment, rental business and so on. Of course, they the tax managers are more knowledgeable because they focus on mining business if their business is mining all the time for more than ten years or more (TO17).

To conclude, the findings for the issue of lack of adequate human resources indicate that the factors of poor competence, shortage of staff and poor management are three most crucial issues when addressing non-compliance. The findings confirmed Baurer’s (2005) claim that there was an imbalance between the organisation’s requirements and the resources needed to meet them.

**6.2.2 Poor data management**

The issues of a lack of reliable data and an unintegrated information system resulting in poor data management were significant obstacles identified by tax officials. They

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60 Data management in this subsection means the process whereby data is acquired, validated, stored, protected, and processed. Data accessibility, reliability, and timeliness are warranted to satisfy the needs of the end users.
alleged that the issue of data availability was a crucial factor impeding any improvement in taxpayer compliance. As stated by a high-ranking official, poor data availability increases the improbability of improving compliance.

How can the tax authority here in Indonesia manage taxpayers to comply? The only way is the data availability. The data issue is one of the most substantial problems in our institution. Despite the laws stated that every institution out there must share their data to us, to the DGT, yet to this day, the process of data transfer from their institution to us is not running smoothly (TO16).

Interviewees suspected that the lack of available and reliable data was due to the reluctance of domestic agencies and organisations to share their information; moreover, even though the law demands it, no penalties are imposed for this reluctance. Moreover, the tax auditors’s tasks are hampered by lengthy procedures and slow-working bureaucracies, as one official expressed in the statement quoted below.

In Indonesia, we have difficulties in requesting information from the bank. The bureaucracy chain is too long. Meanwhile, in India, for example, when the tax authority in India issued a tax audit notification, then its audit supervisor could directly access taxpayer banking information, seised it if necessary and partly paid the tax arrears from taxpayer’s account even when the audit process is still ongoing (TO11).

The lack of access to data and the consequences were confirmed by a partner who briefly explained that adequate data was required in order for the auditor to conduct a thorough audit. He further claimed that the laws need to be revised: “One of the keys is to ease the data accessibility by changing the provision of the law” (TA14). In addition, a senior auditor stated that one of the major obstacles regarding data availability was posed by banks; he explained further that the rigidity of banking secrecy in Indonesia is not new, and that a relaxation of the banking secrecy regulations should ease the burden for auditors.

The most effective way is by tapping the inaccessible data such as the banking data for the audit purposes. Once they are opened, it saves us many troubles. Data access means transparency, and it makes it difficult for taxpayers to hide their suspicious banking activities. (TO21)
Another senior tax auditor mentioned that the issue of the quality of the data might cost the tax office in terms of the correct level of compliance.

Our problem is the data quality. It is our weakness. As a tax auditor, we rely heavily on data and information. To ensure that a taxpayer is conducting either tax avoidance or tax evasion, we need to know the modus of the action. For example, a company set up an SPV (special purpose vehicle) in a tax haven country like the British Virgin Island. Then this SPV created transactions with our auditee, so there was a potential gain or loss due to this transaction. Moreover, we barely knew who the beneficial owner of this SPV is, and this is our limitation to find out the real owner because it is probable that the related transactions occurred there. However, we cannot make sure of it instead of only guessing (TO18).

The next concern was the current DGT’s information system that was perceived as being unable to provide adequate services with respect to improving taxpayer compliance. One tax auditor complained that the computer system in his office was outdated and could not keep up with other related technological developments. “Some taxpayers have implemented a computerised system that is quite sophisticated, in contrast with our system that is lagging behind. The challenges in the future are not easy, such as the application of the cloud system.” (TOo8). Another official admitted that the system was unreliable when it came to monitoring taxpayer activities. This situation gave taxpayers the opportunity to cheat on their tax with only a minimal risk of discovery. The head of a large taxpayer office highlighted that, without a proper system and rigid enforcement, better compliance will be out of reach.

If we want to administer taxpayers thoroughly as requested by the laws, then the appropriate system must be established. Then, after the system is established, we should seriously enforce the law, severely. If the DGT cannot hold the system and the law enforcement itself unreliable, then the noncompliance is getting larger (TOo3).

The unfavourable situation regarding the DGT’s access to and management of data was not unnoticed by some taxpayers. This situation encourages some taxpayers to deploy sophisticated, aggressive tax planning schemes because they are confident that the DGT will be unable to track down their wrongdoings although there is a
mechanism of information exchange (EOI) among tax authorities in various countries to handle this issue.

It is one thing that I am worried to see; some taxpayers remain confident that the EOI mechanism cannot run smoothly, so they are encouraged to have aggressive tax planning schemes in which even their tax advisor cannot explain it or provide satisfactory responses for that schemes. It is one significant non-compliance risk (TO20).

The abovementioned findings indicate that poor data management has dire consequences on the effectiveness of the DGT’s response to non-compliance. Moreover, the reluctance of other government agencies to share their data, the issue of data quality, an unreliable information system and lack of enforcement of rules were seen as the major impediments to a more effective data management situation.

6.2.3 Poor internal coordination

In managing taxpayer non-compliance, ideally the tax authority should be supported by a sound administrative system. However, in most cases, this does not happen in a developing country. Hence, a weak administration leads to taxpayers being less compliant than is desirable. Many participants pointed out that the internal organisation problem prevented the tax authority from having a sound administrative system. One notable issue was related to the poor coordination among tax offices. One official believed that this coordination problem was a result of the tax authority’s broad span of control which led to the many units having diverse perceptions of a particular policy.

There are 331 tax offices around Indonesia from the ones that located in remote areas to the central office, and poor coordination always been a big problem, it caused uncertainty to taxpayers. If every unit had the same perception and committed to supporting each other even though it is not in their interest, then the DGT’s performance will be improved as well as taxpayers’ compliance (TO06).

Further, one advisor pointed out that the poor coordination among units is possibly causing tax office to have difficulties in tracking the actual value of a specific transaction by a taxpayer. The reluctance to share specific information among units
because of sectoral ego may cost the DGT great deal of its tax revenue. Moreover, this type of embezzlement by taxpayer takes time to be uncovered. “The concern now is the tax evasion. Suppose it should be paid in ten, yet it is paid in two. It is hard to be traced; this is one of the DGT’s weaknesses because of the sectoral ego.” (TA07).

Therefore, the issue of wide span of control as the result of geographically dispersed tax offices across Indonesia and the reluctance to share information were considered as two factors that cause the internal coordination problems in the DGT.

### 6.3 Managing non-compliance

Improving compliance by effectively managing non-compliance is one of the primary responsibilities of a tax authority. The OECD (2001) suggested that a systematic design and an effective compliance strategy should be adopted in order to achieve compliance improvement. Subsequently, understanding the causes of non-compliance risks has made tax authority not only aware of the exposure but has also enabled it to formulate an appropriate approach to managing the risks. Hence, the ability to detect non-compliance as a preventive measure, and managing non-compliance as a remedial measure, is necessary for the tax authority.

This section discusses the findings related to the current situation regarding the ability of the DGT to detect and manage non-compliance. Table 6-2 below summarises the number of responses from participants about the related themes. This section will be followed by Section 6.4 (Perception on responsive regulation) in which is integral to answering the second research question.

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<th>Drivers</th>
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<td>Managing noncompliance</td>
<td>Detecting noncompliance</td>
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<td>Managing noncompliance</td>
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6.3.1 Detecting noncompliance

Several participants were pessimistic about the ability of the DGT to detect large business’ non-compliance actions. Surprisingly, many of them were DGT personnel who were unsure whether they could immediately recognise tax fraud during the audit. They pointed out that poor access to reliable information, discussed in Section 6.2, prevented them from carrying out valid detection. “Currently, the measure for detection is not so compelling because we conduct an audit based on the given data by taxpayers. Meanwhile, the external party data like the data from other government agencies are difficult to obtain” (TO14).

Another senior auditor complained that the removal of the auditor’s authority to collect taxpayer data directly at the taxpayer’s premises made the validity of the data provided by the taxpayer somewhat questionable.

The audit examination required quite a long time to conclude. It is easier in the past because we had the power conducting spot audit to collect evidence directly. However, now, we can only ask the taxpayer to provide us with the data needed which sometimes we doubt the validity of it (TO21).

A high-ranking official further added that the exchange of information as a mechanism to obtain detailed international transaction information is inefficient, especially since large businesses frequently conducted activities in tax haven countries. The poor internal channelling transmission of data also caused the quality of the existing information to be somewhat unreliable.

When a taxpayer is creating dubious financial engineering to maximise their profit by various means such as creating international transactions that are beyond our reach, then it is a problem. It is a difficult problem because if we want to know their motive or schemes, we need to ask cross-border clarification for the taxpayer activities. It takes a long time because it is beyond our jurisdiction, and it is not easy to obtain such information (TO03).

Another issue regarding detection is related to the revenue target, which poses the problem of a conflict of interests. A tax advisor, who was independent of the tax authority, revealed that, according to her experience, some information would most
likely be denied by officials. She stated the possibility that a tax office already knew about the fraud yet preferred to ignore it because they did not want to be burdened with extra work, and besides, they had already reached their yearly revenue target. “It could be that the tax office already knew, but they just overlooked it because they had reached their revenue target in that year” (TA06).

Thus, it can be concluded from the above findings that adequate and reliable information, the ineffective mechanism of information exchange, and the revenue target were the main factors preventing the DGT from detecting large businesses’ non-compliance activities.

6.3.2 Managing non-compliance

The participants identified that, currently, the DGT managed large business non-compliance by means of persuasion or by law enforcement61. Persuasion was the soft-measure, whereas the hard-measure involved audit and investigation. One official explained how the DGT handles any non-compliance.

Well, regarding dealing with taxpayer non-compliance. We as the tax authority in Indonesia have multiple steps. The first step is the persuasive way, by sending the clarification letter or the reprimand letter to taxpayers in case that there was unreported data in their return. If they did not follow, then this level can be escalated into a tax audit, or if necessary it can turn into the investigation for a tax crime (TO16).

His opinion was confirmed by his superior that there were certain levels of action taken to address the fraud, from enquiring into the details of the fraud during a counselling session until the final measure was taken – that of investigation. Interestingly, this official emphasised the potential money that could be recouped rather than the severity of the non-compliance.

In short, there are two main things that we do. Firstly, we do monitoring, and secondly, we do law enforcement. When we oversee taxpayers, in the meantime, we also ensure that they follow

61 It is worth noting that this subsection discusses the current efforts by the DGT as the Indonesian tax authority in managing non-compliance that has occurred based on the responses from the participants.
the prevailing laws. We assertively give them a reminder or a clarification letter when we find something unusual. Secondly, we enforced the law according to the industrial sector. Apart from the routine audit, we need to conduct a risk analysis to see whether the proposed audit is revenue gain potential or not. (TO03)

In detail, another tax official explained that the DGT acted differently if the non-compliance was considered to be an instance of tax avoidance or tax evasion. However, he argued that the priority of the DGT was to collect the tax money even when a misdemeanour had occurred.

Regarding aggressive tax planning, it is anticipated by clarification or examination, by the audit. However, when the violation happens in the form of tax evasion then it has become a tax crime, illegal conduct, then we will have an investigation, this is the last step to send the perpetrator to the jail because our primary goal is collecting tax money. Thus, the anticipation measure is clarification which could be escalated to the audit, and the last step is the investigation. Those are the efforts of the DGT to enforce the law. (TO08)

Contrary to the perception of the DGT’s poor anticipation and detection of non-compliance, as discussed in Section 6.3.1, one official perceived that his effort in monitoring his taxpayer was considered as good enough in his office in the LTO 2 since every Account Representative (AR) dealt exclusively only with a limited number of taxpayers. However, the situation was different in other tax offices.

I think our supervision is sufficient enough for large taxpayers in this office. Each AR is in charge at maximum ten taxpayers. It was a different situation when I worked at the Medium Tax Office as one AR was responsible for 30 to 50 taxpayers. The more taxpayers that need to be monitored then the monitoring quality will decline (TO15).

He then added that even though the team in his office had a risk management approach to deal with non-compliance attempts, he preferred to choose a more traditional approach, and scrutinise every single taxpayer regardless of whether or not the taxpayer was a complier. He did this because of the revenue target.
In current situation when the mandate of tax revenue target is so enormous, we do not view whether the taxpayer is already complying, half-complying or not complying. Every one of them who lodges their return received the same treatment. We will compare all their reports with our data, so for complying taxpayers, we cannot set them aside, because the head office and regional office always keep asking about what we have done with those taxpayers (TO15).

One tax auditor revealed that his office had introduced an innovation by purchasing an additional companies information from a private company\(^\text{62}\) to help the auditors deal with the transfer pricing issue. “In our office, we need a comparable data as a tool for transfer pricing audit effectiveness, and our office provided by buying us [an information] database. It is available now, and gives us more access to enquire for data comparability” (TO14).

This is intriguing since the problem of inadequate information was handled separately by a single tax office rather than by the DGT as the parent organisation. This event is evidence of the administrative weaknesses discussed in the Section 6.2.3.

However, despite the inefficiency in managing non-compliance, some advisors acknowledged that it was impossible to expect full compliance outcome if the efforts were solely the responsibility of the DGT without the assistance of other government agencies. He believed that the current mechanism to counter taxpayer non-compliance to some extent was adequate. “I think their mechanism starting from clarification, counselling until the audit is quite useful. Of course, not all of them would comply, and the noncompliance itself can be ranged from the little ignorance until the real big offender” (TA05).

One official stated that non-compliance attempts were always made by taxpayers from time to time despite the countermeasures taken by the tax authority: “It is hard for us to prevent a taxpayer for not trying doing noncompliance breaches. Once we uncover their tricks, they always find another way” (TO05).

\(^{62}\) One example of such provider is Orbis. See [https://www.bvdinfo.com/en-gb](https://www.bvdinfo.com/en-gb) for more information.
The abovementioned findings address the second research question: *How does the tax authority manage large business taxpayers’ compliance risks according to the factors identified by addressing the previous research question?* According to the interviewees’ responses, it can be concluded that the DGT manages the risk of large business compliance by sending letters requesting clarification or by conducting counselling sessions with taxpayers as part of the taxpayer monitoring program. Next, the law enforcement approach is taken if the former approach is unsuccessful, escalating the outcome to a tax audit or even tax investigation if a tax crime has occurred.

**6.4 Perception of responsive regulation**

As mentioned at the beginning of this chapter, tax administration in a developing country like Indonesia has various constraints that might result in a lower compliance outcome. Despite those limitations, ideally, a tax administration is always seeking and implementing the best approach to meet its ultimate goals: collecting taxes in conjunction with improving taxpayers’ compliance. This implies that a systematic design should be adopted by a tax administration to improve taxpayer compliance (OECD, 2001).

The responsive regulation as the alternative approach to improve taxpayer compliance has become a new standard for tax administration mainly in developed countries. The OECD (2004) and the EC (2006) proposed a compliance risk management strategy based on responsive regulation as an approach to tax administration. The main reason for this suggestion is to emphasise the importance of understanding taxpayer behaviour in order to provide the most efficient and effective type of treatment.

Therefore, during the interviews, the key participants were asked about responsive regulation in order to obtain their opinion of the compliance risk management (CRM) approach. One of the critical features of the CRM is that taxpayers are treated according to their level of compliance. In this way, the tax authority can mobilise its resources and prioritise enforcement when dealing with the most blatant and severe cases of non-compliance. This is a more efficient approach in developing countries where budget constraints hamper the efficiency of the tax administration (Braithwaite, 2006).
Many participants agreed that responsive regulation might have a positive impact on the efforts to improve large business compliance in Indonesia. It seems that the group tax manager was the one who was enthusiastic about putting the concept into practice. The tax manager of a mining company argued that, indeed, the most compliant companies deserved to be rewarded for their efforts to comply with the laws and regulations.

It means that a company who has proper taxation management will surely pay attention to the aspect of compliance; comply with the rules and no intention of committing any fraud. When a company complies, and the tax office recognised it then giving a reward or an appreciation, it is fair to them (TM12).

However, although many tax managers agreed, they appeared to be extra cautious about the notion of reward. A manager of an oil company warned that the rewards had to be fair, while another manager in the oil and gas industry doubted whether the authority had a genuine willingness to give the rewards such as, for example, a tax refund.

Perhaps the idea is correct. However, if the taxpayer made mistakes, the tax office will punish taxpayers severely even though the tax office gave the rewards like tax refund in advance. It shows the unwillingness to give the reward, as the auditor expects to have a significant correction when the taxpayer who received that tax refund in advance would be audited afterwards (TM06).

An interesting point made by a tax manager who said that even though he agreed with the concept, he emphasised that rewards should be unnecessary since compliance is an obligation. Moreover, he agreed that no leniency should be shown to those who are defiant. “Compliance must be followed because that is the implication of the law. No need for rewards but just honour them with respect and otherwise send the fear message to those who are not complying. There is a saying in Japanese tax offices: respect among the honest, fear among the dishonest” (TM07).

Several tax officials were agreed with the concept; however, it seems that they were extra careful when stated their mind. A senior auditor concurred with the idea that, “It is unwise to have the same treatment for those who comply and those who do not”
Another tax auditor added that, “There should be criteria that categorise taxpayers as compliant taxpayers in order to qualify for the rewards” (TO18). Also, the reason for discrimination in the treatment of taxpayers was clearly expressed by the head of section: to make the non-compliant become compliant.

To be specific, we should scrutinise causes of noncompliance. So, if there is a taxpayer that does not comply, then he will not immediately get a penalty. We need to find out the cause of noncompliance, a repeated mistake or a repeated intention for not complying. If it is just negligence then no need for a penalty, only warning. So, the treatment will be different from the compliant and the noncompliant. However, again, we need to be careful in scrutinising noncompliance, classifying it and then how to treat it. The goal is to make the non-compliant, compliant (TO12).

However, although they agreed with responsive regulation, some officials pointed out that the internal weaknesses of the DGT may potentially hamper the application of responsive regulation. “There is a shortcoming from the DGT in detecting if a taxpayer was complying or not” (TO11). Another official added that, “No data can ensure substantively that a taxpayer does have technical compliance” (TO16).

Those tax advisors who agreed with the notion of responsive regulation gave various reasons for their agreement. For example, one partner emphasised the issue of fairness: “I agree, and my concern is about the issue of fairness here, how come a compliant taxpayer and those who are outside of the system, are receiving similar treatment. That is unfair” (TA01). Another tax advisor pointed out that without discrimination in treatment, taxpayers would not be motivated to fulfil their obligation (TA03). His opinion was also confirmed by another tax advisor who stated that the compliant taxpayer deserved to be treated differently from the non-compliant one.

There is a need for the DGT to differentiate its treatment. When a taxpayer complied and paid much money, later s/he will question the received benefit. Therefore, a particular treatment should be provided in the form of services or facilities. Otherwise, s/he will think that it is useless to pay so much if the treatment is similar for all (TA07).
Some participants were somewhat sceptical about the concept. One of the main reasons was their perception of tax as an obligatory duty to the nation which did not warrant a reward. For instance, one official expressed her views about the concept of equal or different treatment. “It should be equal treatment. So, either taxpayer who comply or do not comply, they are equal” (TO13). Another official added that complier reward was unnecessary.

Tax is an obligation. Thus, taxpayers must comply with what has been set without any promise of rewards. The consequence of breaking the obligation is receiving punishment. They know the consequences if, for example, they are late to pay or late to report and we also have explained that they can be punished if violating the laws (TO07).

However, despite those who disagreed with the notion of responsive regulation, many who concurred with the idea also emphasised that the precondition requirements should be met by the DGT before adopting it in practical policy. Some issues needed to be addressed before applying the policy. A tax manager pointed out the importance of correctly measuring technical compliance.

Measuring technical compliance is somewhat tricky. It cannot be determined by the amount of tax payment only. The measurement should be precise and could be quantified. It is better not to apply responsive regulation if the measurement is still unclear (TM01).

The issue of measurement criteria was also raised by another manager who pointed out that risk-based management could be a way out for the DGT when deciding their separate treatments. “The rating for tax compliance should be created. Who has the lowest risk could receive the rewards, and the DGT needs to be more focused on transactions with high impact on the revenue” (TM10). This manager’s opinion was in line with the opinion of a high-ranking official that sorting taxpayers according to their compliance can only be done with a reliable system. “The point is we need to have a robust system to oversee taxpayers along with vigorous law enforcement in which those two will direct taxpayers; then we can sort them into very compliant, middle compliant and low compliant taxpayers” (TO03).
Besides the criteria and the system that need to be established to categorise taxpayers, some participants also highlighted the importance of the DGT reviewing its policy on the rewards and punishment scheme. A senior tax advisor stated that an optimal combination of the rewards and punishment is needed instead of focusing only on the penalty because, to earn taxpayer trust, it was vital to stress the aspect of fairness.

There is an approach of stick-and-carrot, and an optimal combination between the stick and the carrot should be formulated beforehand. Currently, the penalty is already quite a lot, from the fines until prosecution, but not the carrot. In the past, there was special treatment for the golden taxpayers so that they could receive a tax refund in advance, but currently, it does not happen anymore; even when there is one then the terms are made to be complicated (TA14).

Another tax advisor emphasised that to earn taxpayer trust, it was essential to create an atmosphere that was conducive to voluntary compliance. She gave an example that the regulations that discourage taxpayer’s motivation for self-compliance such as making a self-correction should be adjusted accordingly.

The law needs to be changed. An example is the customs duty. When an importer wants to make a self-correction to the imported goods, the penalty could be up to 1000 percent. Consequently, they prefer to ignore self-correction than confessing that they made mistakes with the expectation that they will not be caught. In terms of an audit, the penalty for an audit is 48 percent, meanwhile, for a self-correction; the penalty could be up to 150 percent. So that there is no need to make a self-correction, it is better to wait for an audit if they get audited. Therefore, many taxpayers prefer to ignore self-correction although they knew it is wrong (TA08).

Meanwhile, it needs to be reiterated that the DGT has applied some responsive regulation in practice for administrative compliance although several managers and advisors questioned the consistency of its application. “The law states that a taxpayer who met requirements could have tax refund in advance, but it did not run well. The DGT itself is who reluctant to apply it even though the law regulates it. The DGT is not ready; perhaps the first step is fixing the problem in the DGT” (TA12).
The issue of consistency in the application was also highlighted by a tax manager who perceived that somehow the DGT’s policy was established in the interests of its leader rather instead with respect to the mandate of the law. “The issue is in the application, its consistency to assure the taxpayer of the benefit as a compliant taxpayer because currently it is not guaranteed that taxpayer will receive the benefits that they once had received since the changes in the DGT’s top leader means the policy changes as well” (TM02).

Another tax advisor also questioned the seriousness of the institution in respecting the rights of the taxpayer because, due to the revenue target, it seems that the DGT repeatedly made it difficult for a taxpayer to claim his rights, reducing the taxpayers’ willingness to comply, and subsequently leading to a lack of trust.

If a taxpayer complies then when he claims his rights, please process it smoothly. This service will make them comply. I have a client who had difficulties in claiming his rights—his tax refund, although he had met the requirements. Although the regulation remains unchanged but in practice, it was not smoothly executed; they made it more complicated because of the revenue target (TA03).

A senior partner also restated the importance of protecting the rights of the taxpayer. Given the uncertainty and the pressure of the revenue target, the ‘honest’ taxpayers rather than those who are ‘dishonest’ can become the victims. “The honest taxpayers are confused where to ask and complain because the tax supervisory committee is not effectively running. They are afraid if they spoke any louder, then they would have harder repression. There is nobody who can protect the taxpayers’ rights” (TA04).

Therefore, it can be concluded that many participants agreed that if the concept of responsive regulation is to be applied, several problems need to be resolved by the DGT before the program is implemented. The issue of fairness regarding reward and punishment, the problem of consistency in application, and the need for a reliable rating system to measure compliance correctly are some of the vital issues that should be rectified by the tax authority.
6.5 Chapter summary

This chapter explains and discusses findings regarding the causes of the DGT’s current situation and its related themes, thereby addressing the second research question: *How does the tax authority manage large business taxpayers’ compliance risks according to the factors identified by addressing the previous research question?* The findings in this chapter demonstrate that the DGT manages the issue of non-compliance by two means of approaches: persuasion and law enforcement whereby the handling of the problem is carried out in stages.

The findings in this chapter also indicate that three fundamental factors prevent the DGT from effectively managing non-compliance: human resources problem, lack of access to data and inherent administrative weaknesses. Firstly, the human resource problem includes the issue of integrity and corruption. However, the overall integrity of tax officials is improving, and the level of corruption is not as severe, although many participants believed that the level of professionalism has declined. The interviewees believed that the lack of professionalism could be attributed to the abuse of power, the biased interpretation of the law, and the pressure of having to meet the revenue target. The issues of incompetence and staff shortages also exacerbated the human resources problem. Secondly, the findings show that lack of access to adequate and reliable data prevented optimal compliance, as did the poor enforcement of regulations and lack of cooperation among other government agencies. Thirdly, the administrative weaknesses were caused by poor coordination, the unreliable information system and poor human resource management. Also, several participants believed that the inaccessibility of data prevented the DGT from detecting taxpayer non-compliance.

Furthermore, the concept of responsive regulation with the incorporation of compliance risk management as the alternative approach to enhance taxpayer compliance is regarded as feasible by many participants. However, the DGT should address some of precondition requirements before launching the program; these include the issue of fairness, the problem of consistency and the implementation of a reliable rating system to measure accurately the level of compliance.
CHAPTER 7
DISCUSSION

7.1. Introduction

The previous two chapters discussed the results of the qualitative analysis relevant to the research questions of this thesis. This chapter elaborates upon these results that emerged from the collected data and its policy implications. In detail, this chapter analyses and discusses the findings presented in Chapter 5 and Chapter 6 that are centred on five themes: (1) corporate factors; (2) regulation factors; (3) The DGT’s current capacity to respond; (4) managing non-compliance, and (5) perceptions of responsive regulation.

7.2 Corporate factors

This section discusses findings regarding corporate factors. Three specific findings and their components will be discussed in this section: (1) economic factors that consist of cost-benefit-driven decisions, compensation of manager, detection probability and penalties, risk appetite, and uncertainty, (2) socio-psychological aspects which consist of personal norms, social norms and fairness and trust, (3) corporate characteristics that consist of tax risk management, ownership structure and business size, business profitability and the use of tax advisors. The findings of this thesis regarding the regulation factor are discussed and compared with those in the research literature.  

7.2.1 Economic factors

The findings indicate that regarding economic factors, participants considered that there were five significant related issues, namely: (1) cost-benefit-driven decisions, (2) compensation of manager, (3) probability of detection and penalty, (4) risk appetite and (5) uncertainty. This is consistent with past research where the taxpayer was assumed to be a rational creature whose decision to comply is influenced by cost-

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63 The OECD (2004, p.40) shows that the factors influencing the compliance behaviour of business could be categorised into five main factors, namely: business profile, industry, sociological, economic and psychological factors.

64 Recall Section 5.2.1 for detail.
benefit considerations (Becker, 1967; Allingham & Sandmo, 1972; Yitzhaki, 1974). Taxpayers choose to comply after calculating whether they will be financially better off by taking such action regarding their tax liabilities. The other variables such as the probability of detection and penalty are consistent with past research (Alm & McKee, 1992; Li, 2010; Torgler, 2007). For instance, the magnitude of a possible penalty affects the taxpayer's decision to either comply or not comply with tax requirements. Interestingly, none of the participants mentioned that the tax rate is a factor that influences compliance, although some literature has stated otherwise (Loo, 2006; Torgler, 2007; Li, 2010). For example, Downs and Stetson (2014) argued that taxpayers are more willing to be non-compliant in a situation where the increase in tax rate means that the evasion of tax is more profitable. Quite possibly, participants did not consider the tax rate factor as influencing tax compliance or otherwise, since the Indonesian statutory tax rate is among the lowest among the other members of G20. A detailed discussion of the economic factors is presented below in subsections 7.2.1.1 to 7.2.1.5.

7.2.1.1 Cost-benefit driven decisions

The participants view large business as a rational economic animal, the actions of which are always determined by the cost-benefit factor as shown by the findings in subsection 5.2.1.1. Hence, this factor is significant particularly in terms of the way in which a large business conducts its tax planning, regardless of whether the strategy is likely to attract the attention of the tax authority. The findings are supported by the literature suggesting that the taxpayer is a logical entity that seeks to maximise its utility (Becker, 1967; Allingham & Sandmo, 1972; Yitzhaki, 1974; Kinsley, 1992). One consideration that determines cost-benefit-driven decisions is the cost of compliance, since an increase in this cost may potentially affect a corporation’s compliance. Although, in Indonesia, the cost of corporate tax compliance is comparatively low (Susila & Pope, 2013). However, in the current situation where many large businesses conduct their activities on a global scale, the tax authority may tighten its grip in order to protect its own interests as well as curb non-compliance, as the burden of

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65 Currently, the statutory corporate income tax rate in Indonesia is 25 percent and it is expected to decrease to 18 percent in 2020 (Devereux et al., 2016).
compliance cost would be higher. To some extent, this would increase the risk of non-compliance by large business and could lead to more aggressive tax planning schemes.

### 7.2.1.2 Compensation of manager

The findings in relation of compensation of manager show that for the tax manager group of participants, the issue of manager’s compensation was considered as somewhat unrelated to performance in terms of the business’ profitability. The reason given for this was that in a large business, the tax department is seen to play a non-critical role, merely supporting the administration. Moreover, in Indonesia a pre-calculated bonus offered to a manager the previous year (presumably for cost-saving) is not a factor that significantly influences compliance. This finding is somewhat inconsistent with the claim that compensation-based packages are strongly related with tax avoidance (Taylor & Richardson, 2014; Crocker & Slemrod, 2005). Taylor and Richardson (2014), for example, in their empirical research of the dataset of 200 listed Australian companies from 2006 to 2010, found that the expertise of the executive, the bonus-based performance and the international status of the company are three factors that influence non-compliance. Arguably, these three factors encourage tax managers to seek ways to lower their effective tax rates, thereby increasing the risk of non-compliance (Phillips, 2003; Rego & Wilson, 2012; Powers, Robinson, & Stomberg, 2013). However, it is worth noting that a corporation’s formulation and calculation of compensation could become a determining factor that affects compliance. Further, it is important to consider that the corporate culture in Indonesia and other developing countries may be quite different from that in developed countries. Moreover, the findings presented in this subsection provide new insights on the factor of manager compensation as a significant determinant of non-compliance. However, the finding should be taken cautiously as there are many factors that may affect the accuracy of the participants’ answers in relation to this sensitive issue. Hence, a further investigation may be needed to ensure the validity of the mentioned finding.

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66 The study of Susila & Pope did not include the latest development regarding how the tax compliance cost was measured. See Evans et al., (2016) whose study suggests that three broad drivers of tax compliance costs are perceived by taxpayers: the complexity and uncertainty of tax rules, the administrative compliance requirements imposed by tax authorities, and international exposure

67 Recall subsection 5.2.1.2 for detail.
7.2.1.3 Detection probabilities and penalty

The related findings indicate that the severity of the audit results made taxpayers aware of their compliance status. First, the penalties imposed as a result of their ignorance made some post-audited companies change their attitude and make some improvements concerning compliance. This is consistent with past research suggesting that the rigour of assessment during the audit may influence the taxpayer’s compliance level (Strumpel, 1969) and the audit as a deterrence tool would influence taxpayer compliance (Dubin et al., 1990; Alm et al., 2012).

Secondly, it was also found that not every penalty has an equally effective deterrent effect, and taxpayers tended to ignore the penalty if they perceived it to be relatively harmless to the company. The penalty for late lodgement of the VAT return or the income tax return, for example, was regarded as inconsequential for many taxpayers and they tended to ignore it in regard to the lateness, although it would affect their compliance on the criteria of filing a tax return. This finding regarding the ineffectiveness of a penalty is consistent with past research which indicated that the severity of a penalty would affect compliance (Beck & Jung; 1989; Kirchler et al., 2014). Therefore, it is plausible to conclude that a severe penalty may be a deterrent and, moreover, penalties imposed on the tax managers would be more effective in reducing tax evasion than those imposed on the business (Crocker & Slemrod, 2005).

Finally, it was found that there was a low probability that a taxpayer would be audited. This encouraged taxpayers with a greater propensity for risk-taking to be non-compliant because they knew that the probability of being caught and audited was small. Moreover, it is a fact that the DGT’s overall audit productivity has been low. For instance, in 2004 there were more than 40,000 unfinished audit cases and approximately of 65 percent of audits were tax refund audits (Rizal, 2011), suggesting that resources should be allocated to field audits and more productive cases (Le Borgne et al., 2008). Furthermore, the DGT in the past has had a limited number of tax auditors, accounting for only around seven percent of total staff, far below the international benchmark 30 percent of the total staff required for revenue

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68 Recall Sub-section 5.2.1.3 for more detail.
administration (Gallagher, 2005). The finding regarding the low probability of detection is consistent with the findings of Chen and Chu (2005) and Morse et al. (2009) who found that a taxpayer might consider tax evasion if there was only a small risk of detection.

7.2.1.4 Risk appetite

The findings indicate that the factor related to business size and its closeness to someone influential might affect the risk appetite level. Moreover, it was also found that the risk appetite was lower if the company kept its distance from a government official. These findings are consistent with those of Skinner and Slemrod (1985) that taxpayers can have different risk appetite, which in this case was influenced by the size of the business, and subsequently, minor changes in risk appetite may have a profound effect on the compliance.

The COSO (2011) supported this view by stating that many large businesses have a formalised risk appetite as part of their risk management strategy. Having a formalised risk appetite measure implies that the compliance of a business is likely to become non-compliance in an attempt to minimise its tax inefficiencies. As argued by Deloitte (2008, p.10), “tax inefficiencies or missed opportunities [are] resulting from low-risk appetite.”

Further, regarding risk appetite, the role of the business owner is crucial since the risk acceptance level is affected at least by two factors: his/her share of ownership in the business and an internal personal factor such as the unwillingness to be in conflict with the tax authority (Blakelock & Whitney, 2015). On the other hand, the business owner may be willing to take more risks if s/he has a close relationship with one or more high-ranking officials in the country. Moreover, the reputation factor may also influence the attitude of large business toward compliance and may decrease their level of risk appetite.

69 Recall Sub-section 5.2.1.4 for more detail of the findings in relation to risk appetite.
7.2.1.5 Uncertainty

The findings related to the factor of uncertainty show that uncertainty occurs because of the issue of having a correct interpretation of the law and because there is inconsistency and lack of standardization in the way that officers in different areas treat similar issues.²⁰ This finding is aligned with that of the empirical research conducted by Casey and Scholz (1991) and Taylor and Richardson (2013): that uncertainty affects compliance since the taxpayers are unlikely to have full knowledge of the interpretation of the law and, as a result, this situation of uncertainty would affect compliance behaviour. This implies that taxpayers maintain a favourable tax position based on their understanding of the law, and they wait for an investigation by the tax authority even though they know either consciously or subconsciously that their precarious tax position is likely to be challenged. Secondly, the non-standardised treatment given to taxpayers by tax officials across the region for a similar issue makes the taxpayers uncertain about the correct tax position. As shown by the finding in this subsection, this occurs because of the lack of professionalism of tax officers when managing particular issues, it most likely occurs because of the pressure of meeting a revenue target.

7.3.2 Socio-psychological aspects

This section discusses the non-economic factors that affect corporate tax compliance. The factors discussed are personal norms, social norms, fairness, and trust in government. As a fictitious entity, the behaviour of a corporation is most likely influenced by the attitude of its managers. Hence, the compliance of a company is decided by their managers (Joulfaian, 2000; Koester et al., 2013; Olsen & Stakelberg, 2015). Each manager brings his/her personal norms and social norms to the corporation and the combination of these sets the tone of corporate compliance. Further, since a corporation is an organisation comprised of people, it is worth noting that of the interaction among managers would determine the behaviour of the corporation (Ariel, 2012). Therefore, the managers’ personal norms, social norms, sense of fairness, and trust in government are individual characteristics that will drive the

²⁰ See Sub-section 5.2.1.5 for more information.
behaviour of their corporation (Chyz, 2013; Chyz et al., 2014; Law & Mills, 2017; Olsen & Stekelberg, 2015; Koester et al., 2014; Gaertner, 2014).

7.3.2.1 Individual - personal norms and social norms

The findings indicate that the personal attitude of managers influence how the corporation will comply. The personal attitudes resulting from thoughts, customs, beliefs and nationality were regarded by participants as the factors that shaped the manager’s norms. This is consistent with the study of Law and Mills (2017) which found that one of the critical determinants of corporate tax behaviour is personal norms. Further, Bobek et al., (2007) showed in their empirical research that one of two significant factors that influence tax compliance in Australia, the USA and Singapore was the taxpayers’ attitudes. Some researchers also found that cultural differences affected their tax morale (Torgler, 2007; Bobek et al., 2013; Blanthorne & Kaplan, 2008; Wenzel, 2005). Also, Traxler (2010) argued that the attitude of one individual can be affected by others, so it was an interdependent situation. Further, personal norms and social norms were intertwined with values derived from ethnicity or country, and they were affecting compliance in a complicated way (Bobek et al., 2013). The arguments of Traxler (2010) and Bobek et al. (2013) are consistent with the finding in this thesis that the attitude of the individual towards taxes was influenced by his/her colleagues who shared similar nationalities; consequently, different nationalities may have different opinions about tax compliance. Surprisingly, many participants believed that local companies were less compliant than overseas companies. This confirms what Wenzel (2005) noted: that ethics and social norms affect tax compliance.

7.3.2.2 Corporate norms - reputation

The findings in relation of corporate reputation demonstrate that reputation is a fundamental element of a large business that needs to be maintained. It is consistent with the result of some empirical research that the large multinationals ought to maintain their reputation (Cooper, 1994; Oats & Tuck, 2008; Toumi, 2009; Mulligan &

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71 Recall Sub-section 5.2.2.1 for more detail regarding the findings of individual- personal and social norms.

72 Recall Sub-section 5.2.2.2 for more detail regarding the findings that related to corporate social norms- reputation.
Oats, 2009). For example, a firm’s stock value could decrease if its non-compliance is made public with the revelation of unethical conduct of non-compliance such as engaging tax shelters (Hanlon & Slemrod, 2009). Moreover, some managers believe that by maintaining a good reputation, they are perceived as acting in the interests of shareholders (Erle, 2008). Graham et al. (2013) argued that reputation is a deciding factor for managers when implementing a tax planning strategy, since failure would incur the cost of a loss of reputation for the firms. Hence, reputational cost is frequently suggested as a crucial factor that limits the deliberation of tax avoidance (Gallemore et al., 2014). Lavermicocca (2011) found that there was a consensus among large businesses that non-compliant tax behaviour will negatively impact on their reputation.

Another finding in this subsection indicates that large businesses feared that their reputation would be damaged if their misconduct were exposed to the public. This finding is consistent with Williams (2007) and Erle (2008) who pointed out that corporate reputation was at stake due to an ethical issue if corporate compliance came under public scrutiny or became the subject of legal action. Further, Ford (2005) claimed that large businesses have more to fear than do the individuals regarding reputational cost. One interview participant (TA04) mentioned that the mechanism of naming and shaming was effective as a deterrent for a corporation as its staff would be more mindful of their conduct. Hence, the effect of reputation damage is much more pronounced for a corporation for which reputation is a significant asset, than it is for the individual (Ford, 2005).

Interestingly, participants expressed disparate opinions regarding the issue of reputation and the business profitability. Some tax managers highlighted that the importance of reputation was more important than business profitability. However, several other managers stated otherwise. It is worth noting that the issue here is how to strike a balance between a reduced tax burden and reputational costs. Loretz and Moore (2013) argued that managers should balance the benefits of a tax savings scheme against the loss of reputational costs. Further, there would be pressure from the respective industry if these managers attempted to deviate too much from what their peers did in relation to their tax planning. Therefore, although large businesses are expected to be effective in optimising their tax affairs, the interdependence among
peers would constrain their tax planning because of the reputational costs. However, it is also worth noting that the manager’s attitude toward the reputation risks would determine the tax planning approach. Therefore, a more risk-taking manager may seek tax savings more aggressively at the expense of reputational costs (Lavermicocca, 2009).

7.3.2.3 Fairness and trust in government

The findings indicate that the factor of fairness and trust in government influence large businesses’ compliance. Several tax researchers have demonstrated that the anticipation of being mistreated by the tax authority had an adverse influence on compliance (Slemrod, 1992; Wenzel, 2002; Murphy 2004b; Slemrod, 2007; Schweitzer & Gibson, 2008). Although past research has predominantly focused on the individual taxpayer, the insights of the results are arguably applicable to corporate tax compliance since the corporation is an entity that comprises individuals, and the behaviour of people within a corporation affects corporate compliance. Also, there are several fairness considerations that may affect corporate tax compliance if it were conducted properly. Hence, taxpayers are more inclined to comply with tax rules when they perceive that the tax system is fair (Slemrod, 2007; Schweitzer & Gibson, 2008).

The findings of subsection 5.2.2.3 also show that the factor of lack of trust applies not only to the tax authority as the tax collector, but also refers to lack of trust in the government. This is consistent with past research (Torgler, 2003; Torgler, 2008; Alm et al., 2006; Kirchler et al., 2008; Bird, 2008; Cheema, 2010) which found that, in general, the level of trust in the government and its officials affects the level of compliance. The

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73 Recall Sub-section 5.2.2.3 for more information regarding the findings related to fairness and trust in government.

74 Several fairness aspects have been found important for tax compliance. They are:

1. Distributive justice: the feeling that society does not have sufficient allocation of goods compared to the tax that one must pay (Wenzel, 2002; Verboon & Van Dijke, 2007).
2. Retributive justice: the perception that tax authority imposes the appropriate sanctions in the case of rules-breaking (Wenzel, 2002; Walsh, 2012).
3. Procedural justice: the perceived fairness that refers to the fairness of the procedures and treatment receives from the authority (Wenzel, 2002; Murphy et al. 2009).
4. Horizontal equity: refers to the equal treatment of a taxpayer relative to other taxpayers in a similar circumstance (Goetz, 1978; Kinsey & Grasmick, 1993).
5. Vertical equity: refers to the fairness of the burden of taxes for certain social strata relative to other strata (Kinsey & Grasmick, 1993; Wenzel, 2002).
trust between the taxpayer and the government not only shapes a sound tax system (Bird, 2008), but also influences the taxpayer’s willingness to pay taxes (Alm et al., 2006). Further, taxpayers view this relationship as a form of exchange since this relationship between government and the taxpayers is such dynamic interaction which means an increase in trust may cause an increase of perceived power and consequently, an inclination to comply. Moreover, the changes in the level of trust might influence the legitimacy of the government in collecting taxes (Turner, 2005) and as a result, a low trust in the government and tax authority increases the level of tax evasion (Richardson, 2008; Kirchler et al., 2008).

7.3.3 Corporate characteristics

7.3.3.1 Tax risk management

The findings indicate that many participants agreed that a robust internal control or an established tax risk management strategy played a vital role in ensuring compliance, although it was found that many large businesses in Indonesia did not support an adequate and firm internal control of tax-related matters in their business. This is consistent with the assertion made by Chen and Chu (2005) that a business with a robust internal control tended to have lower corporate tax evasion. Moreover, tax compliance in a large business could depend on internal control and the strength of employees’ collaboration since not all tax decisions are made by those who are responsible (van Dijk & Siglé, 2016). Secondly, despite the surprising finding that many large businesses in Indonesia did not establish a sound tax risk management system, this phenomenon occurred in other countries as well. Segal, Segal and Maroun (2017) found that several large businesses in South Africa had knowledge of the sound tax risk management practices, but they were not correctly implementing these practices in their business. Further, a survey by KPMG in 2007 found that 31 percent of the tax manager respondents in the US did not consider that tax risk management was a top priority strategy, while 60 percent of them responded that they did not have a documented tax risk management strategy (Lavermicocca, 2012). In Australia, Lavermicocca (2011) found that although her participants were aware that tax risk management (TRM) was an emerging issue and that the ATO had stated the

75 See Sub-section 5.2.3.1 for more detail about the findings related to the factor tax risk management.
importance of a tax risk management arrangement, only half of them had a formalised and documented TRM system.

The findings presented in this subsection also indicate that the factor of cost-benefit consideration contributed to the low priority given to establishing a robust internal tax control strategy in the company. This aligns with the findings of Erle (2008): that many companies still viewed tax as being only a cost factor, and that managers on behalf of shareholders must minimise the cost although at some point a relative balance is needed between the level of accepted risks and the level of aggressive tax planning. As part of the corporate governance system, the role of tax risk management has become much more important these days with the tightening of regulations especially those with a strong focus on reliable internal control. The short-term vision of management who think that tax is only a cost factor needs to shift to a longer-term perspective, by adding the value of the company’s sustainability by maintaining its reputation and at the same time, strategically minimising the effective tax rate. As a result, annual reports will reflect the quality of management and the public will later evaluate this quality. Otherwise, the failure of management to identify significant tax risks and its failure to develop an appropriate strategy to anticipate and deal with potential problems may cost the company more than tax payment.

7.3.3.2 Ownership structure and business size

The findings in relation with the factor of ownership structure and business size show that the listed companies were perceived by participants as having better tax compliance than do the non-listed companies.76 This finding is consistent with past research which found that the ownership structure to some extent influences corporate tax compliance (Hanlon et al., 2005; Desai & Dhamapala, 2006; Slemrod, 2007; Chen et al., 2010; McGuire et al., 2012; Badertscher et al., 2013). The empirical research by Hanlon et al. (2005) in the United States indicated that there was a relationship between corporation characteristics and non-compliance. Moreover, tax non-compliance was influenced by the company status as either a multinational or a domestic company, and whether it was a publicly listed company. In numerical terms, Slemrod (2007) showed that on average, in the United States, the non-listed

76 Recall Sub-section 5.2.3.2 for more detail regarding the findings.
companies had deficiency rates of 17.1 percent compared with 12.5 percent for listed companies. This is consistent with Cloyd (1995) and Cloyd et al. (1996) who claimed that the factor of lacking incentives for less-constrained financial reporting made the non-listed companies more tax aggressive. Therefore, as asserted by Hanlon et al. (2005), the non-listed company could be associated with potentially higher risks of non-compliance because of lacking the incentive to report its financial status publicly.

Second, the findings indicate that the industrial sector to which a particular company belongs is another factor that does influence non-compliance. This supports past research demonstrating that, in the United States, there is a relationship between a certain industrial sector and its non-compliance rates (Hanlon et al., 2005). Giles (2000, p.264) stated that “there is a significant variation in the probabilities of compliance avoidance and evasion across different industrial sectors of the economy” after he examined the cases audited in New Zealand from 1993 to 1995. Further, Sapici et al. (2014) support the argument that there is a relationship between the business sectors and corporate taxpayer non-compliance in Malaysia. However, the findings of the relationship between non-compliance and the industrial sector should be treated with caution since there is no consensus in past research about the type of industry that is riskier than others. Moreover, although several other factors influence corporate compliance and may be more significant than the industry-type factor, it is worth noting that the IMF recommends that the industrial sector is a factor to be considered when identifying risks and establishing a compliance-risk-recognition system for a tax administration (Russel, 2010). In addition, the findings presented in this subsection demonstrate that the banking sector has better compliance than the mining sector, providing new insights and warranting further research.\(^{77}\)

Last, the findings in this subsection show that the multinational corporation that utilises tax havens was perceived to have a higher level of non-compliance. This supports past research indicating that the factors of multi-nationality and tax haven utilisation are significantly associated with corporate tax non-compliance (Slemrod, 77 One main reason for the banking industry being perceived as having better compliance was the factor of being well-regulated and having many ‘watchdogs’ or the external supervisory agencies. Hence, this has accustomed the banking industry to being more aware of regulations, and they have a stronger mechanism for anticipating regulatory complexities and regulation changes.
2001; Rego, 2003; Beuselinck et al., 2005; Hanlon et al, 2005; Desai et al., 2006; Dyreng et al., 2008; Lisowsky, 2010; Taylor and Richardson, 2012). The multinational companies use global tax planning schemes to minimise their effective tax rates and frequently take full advantage of the low tax rate jurisdictions (Slemrod, 2001). Rego (2003) supports this claim by showing that the multinational corporations in the United States have more ability to avoid taxes than the domestic-only corporations, providing evidence that the US multinational corporations have lower worldwide effective tax rates. Hanlon et al. (2005) claim that foreign-controlled firms have more than double the tax avoidance activities of the domestic-controlled firms. Moreover, a tax haven is frequently utilised to reallocate the domestic taxable income and to minimise a foreign-source income with the final objective of reducing the tax paid at the domestic level (Desai et al., 2006). Moreover, Lisowsky (2010) shows that the likelihood of a company using a tax haven is positively related to the presence of its subsidiaries at the tax haven location. Therefore, it is worth highlighting that the manipulation of transfer pricing transactions by a multinational corporation that owns subsidiaries in tax haven countries signifies the intention to avoid taxes either legally or illegally, and this factor is very likely to be red-flagged by the tax authority.

7.3.3.3 Business profitability

The findings described in subsection 5.2.3.3 indicate that the factor of financial constraints faced by a large business affects its corporate compliance. This supports the past research finding that the company with financial constraints tends to have lower effective tax rates (Edward et al., 2016; Law & Mills, 2015; Dyreng & Markle, 2016; Akamah et al., 2016). Edward et al. (2016) argued that due to financial constraints, managers tend to focus more on generating additional cash flows, and are less concerned about reporting their current earnings. Further, a more aggressive tax planning is applied by utilising deferred-based strategies to increase tax savings. Law and Mills (2015) indicated that financially constrained companies are using more negative words in their financial reports and they reported higher unrecognised tax benefits while utilising more tax haven operations with the objective of having lower effective tax rates. Dyreng and Markle (2016) found that in the US, financially constrained multinationals shifted less income to their affiliated companies overseas than did their unconstrained peers. Therefore, there is a positive association between
the current financial constraints and the more laborious attempts to pursue tax aggressiveness (Akamah et al., 2016). It was also found that this positive association becomes insignificant if the management has corporate general counsel in their organisation structure and has a debt-based bonus system. Further, the financial constraints may come as the result of corporate financial hardships or global financial distress, both of which influence corporate tax compliance (Richardson, Taylor & Lanis, 2015). It is worth noting that, to date, the study of financial constraints as a factor that affects compliance is still limited in the area of tax compliance; hence, the findings of this subsection that: (1) the level of non-compliance is escalated when a company facing a crisis utilises more tax aggressiveness to increase tax savings, and (2) maintaining operations becomes the management’s priority rather than fulfilling the obligation to the government, provide additional insights in the research of financial constraints as the influencing factor of corporate tax compliance in developing countries.

### 7.3.3.4 Use of a tax advisor

The findings indicate that the use of an external tax advisor may have either a positive or a negative effect on corporate tax compliance.\(^{78}\) This is consistent with past research findings that a tax advisor may help taxpayers to exploit any ambiguities in the law or alternatively encourage taxpayers to fully obey the law by avoiding reporting positions that are likely to be challenged by the authorities (Klepper & Nagin, 1989; Spilker et al. 1999; Tan, 2011; Wurth & Braithwaite, 2016). In the case of Indonesia, Susila & Pope (2012) state that tax advisors are used by the large businesses because the policy of using an external advisor comes from the taxpayers’ headquarters (52.47%) and, secondly, corporations rely on tax advisor services mostly at the time of tax audits, tax objections and tax appeals. Of the researchers reported that the retail and wholesale trading sectors are those that tend to use the tax advisor services compared to other sectors. Moreover, the company’s maturity level has a negative correlation with the use of a tax advisor.

Regarding the exploitation of ambiguities in the law, a study conducted by Spilker et al. (1999) provided evidence that the external tax practitioners exploit specific tax rules.

\(^{78}\) Recall Sub-section 5.2.3.4 for more information regarding the findings.
to achieve client-preferred results in planning decision contexts. This study further distinguished the various levels of aggressiveness in interpreting ambiguity: a more conservative approach is applied in the planning decision context, whereas a more aggressive approach is taken in regard to compliance. Wurth and Braithwaite (2016, p.13) confirmed the findings of this previous study and added that “tax practitioners in the aggressive group were distinguished by an increased propensity to compromise their preparation ethics and exploit the opportunity afforded by ambiguity within their clients; tax affairs”. It appears that the external tax advisors provide advice regarding tax law ambiguity according to their clients’ risk-taking propensities and they are afraid to lose their clients if they cannot meet their clients’ demands (Tan, 2011). Further, Tan (2011) argued that the larger advisory firms tend to have larger companies as clients; because such companies tend to have more complex transactions, tax advisors need to offer more alternatives for avoiding taxes. Therefore, past research findings are consistent with the finding of this study: that the propensity to use a more aggressive tax planning strategy was initiated by large companies, and the objective of the tax advisors is to comply as much as possible with the wishes of their clients.

7.2 Regulation factor

This section discusses findings regarding the regulation factor; four specific findings will be discussed: (1) complexity in regulation, (2) ambiguity in regulation, (3) regulatory overlap, and (4) unfairness in regulation. The findings here will be compared with those of past research studies.

7.2.1 Complexity in regulation

The findings show that the complexity of a regulation may result in tax officials taking unpredictable actions.79 The unpredictability is a result of the combination of the lack of clarity in the regulation, insufficient expertise, a loosely-applied standard, and the tax authority’s inadequate and inefficient oversight. This is consistent with past research indicating that the government should address the issue of regulation complexity since it results in uncertainty and negatively influences taxpayers’

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79 See Sub-section 5.3.1 for detail regarding the findings related to the factor of complexity in regulation.
compliance (OECD, 2004; Baurer, 2005; Osofsky, 2011; Kirchler, 2007). The certainty in regulation as opposed to uncertainty is recognised in the civil law tradition\(^\text{80}\) as “a maximum predictability of officials’ behaviour” (Claes & Krolikowski, 2009, p.92). The issue of uncertainty emerges when the regulation is vaguely crafted or ambiguously drafted or when it is issued with a retroactive effect, and this uncertainty exacerbates the complexity of the regulation. Moreover, the factor of regulation complexity may lead to increased opportunities for taxpayers to engage in non-compliant behaviour (Cuccia & Carnes, 2001; OECD, 2004). The gravity of this complicated situation is evident in taxpayers’ reduced trust in the government (Braithwaite, 2003); at the same time, the tax authority finds itself in the situation where it has to accurately interpret and execute the law accurately (Kirchler, 2007); in turn, this may decrease the level of voluntary compliance. Hence, the complexity and ambiguity of a tax regulation has a negative impact on corporate tax compliance and this will continue unless the underlying cause of the problem is addressed, and uncertainty is eliminated.

### 7.2.2 Ambiguity in regulation

The findings indicate that the issue of ambiguity in regulation makes the authority less accurate in executing of what required by the law as well as it makes taxpayer fails to meet on what the laws required.\(^\text{81}\) This is consistent with past research showing that the ambiguity and complexity of laws have a negative impact on tax compliance (Agha & Haughton, 1996; Erle, 2008; Kirchler, 2007; Cuccia & Carnes, 2001; Sandmo, 2005). Ambiguity in the law occurs when there is lack of clarity or when there is uncertainty regarding the meaning or application of a term (Schane, 2006). The ambiguity in regulation creates uncertainty in taxpayers, and it has become a challenge for corporate governance systems to ensure full compliance with all legal requirements (Erle, 2008). For example, ambiguity in regulation may cause a misinterpretation, and as a result, taxpayers have difficulties in understanding it fully, leading to a situation of unintentional non-compliance (Agha & Haughton, 1996). The ambiguity in the tax laws makes it difficult for the authority to execute what is required by the law precisely; meanwhile, from the perspective of taxpayers, ambiguity might be regarded

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\(^{80}\) The law in Indonesia is principally based on a civil law system (the Roman Dutch law), intermixed with traditional customary law (Hukum Adat).

\(^{81}\) Recall Sub-section 5.3.2 for more information regarding the finding.
as the opportunity to reduce tax payment (Kirchler, 2007). Interestingly, experts or external tax advisors might encourage non-compliance regarding ambiguous income sources (Klepper, Mazur & Nagin, 1991). The tax advisors might exploit the ambiguity to the advantage of their clients as they have more flexibility and capability in interpreting the law (Tan, 2011). Therefore, the ambiguity negatively affects corporate tax compliance with three consequences: (1) an increase in the ambiguity may decrease expected government revenues; (2) an increase in the ambiguity may decrease taxpayers’ expected liability; and (3) an increase in the ambiguity may negatively affect social welfare because of the shortage of government funds.

In Indonesia, the issue of ambiguity in regulation is more complicated because of factors such as the inherent characteristics of the law, one of which is the language. The characteristics of the Indonesian language complicate the process of phrasing a law as the language has no tenses and many derivational affixes – either suffixes or prefixes – with which to form a word (Uliniansyah, Ishizaki & Uchiyama, 2004). This factor creates confusion and uncertainty for the taxpayer when trying to interpret the law accurately and acting upon it appropriately. Apart from the language, a more extensive problem that produces multiple interpretations is caused by the fact that the tax legislation in Indonesia is somewhat vague. As stated by some of the interviewees, the tax law in Indonesia was ‘thin’ and too general. For example, the income tax legislation in Australia is more than 8000 pages in length (Wallis, 2006) and is more detailed in comparison with the Indonesian tax legislation which is contained within fewer than 100 pages. This simplicity causes a problem as the law excessively delegates power to its subordinate regulations. Consequently, laws may be challenged, particularly if an agent has a personal agenda. Moreover, the issue of regulations’ binding power may arise because of the ‘sectoral ego’82 of institutions. As a result, other agencies may be reluctant to obey the issued regulations because of inter-agency rivalry. Hence, loopholes and contradictions in regulations are evidence of the ambiguity problem; furthermore, the level of trust in government to some extent is influenced by the clarity of the tax laws. Therefore, badly-designed regulations with many confusing rules or many conflicting interpretations will exacerbate the

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82 The ‘sectoral ego’ is a local term for the reluctance of many government institutions to cooperate with each other, not because of inability but because of a misplaced sense of pride or authority among institutions.
inclination to compliance. Evidently, a synergy between the tax official, the tax experts and the professional drafter of legislation will provide real benefits.

7.2.3 Regulatory overlap

The findings demonstrate that regulatory overlap creates a waste of resources and occurs because of conflicting regulations and lack of coordination. The result of this overlap is confusion and uncertainty among taxpayers that in turn affects their tax compliance. This finding is consistent with the past research finding that regulatory overlap creates a waste of resources (Ahdieh, 2006; Aagaard, 2011; Li, 2015; Middleton, 2015). In general, the issue of regulatory overlap is caused by four major issues: conflict, complexity, duplication and lack of coordination (Aagaard, 2011). In the case of Indonesia, the inconsistency of the laws with overlapping regulations produced either conflicting regulations or duplicated rules. The lack of coordination among agencies exacerbated the overlap situation since every agency has its own agenda and even the regular coordination meetings are frequently nothing but a formality. As a result, the regulatory overlap that occurs among various agencies or between the central and the local governments causes confusion and uncertainty for business (O’Callaghan, 2010). Further, this regulatory overlap is adding more challenges to the regulatory frameworks in Indonesia because, as indicated by the report of the World Justice Project (2014), the functioning of courts, where the court is perceived to be independent and segregated from the government interference is still far from ideal, since it is still affected by powerful private interests. Therefore, the issue of regulatory overlap with respect to tax compliance has several implications as follows: (1) interagency regulatory overlap in the enforcement scheme may have different consequences for the regulators and the taxpayers; (2) the superior agency should police and coordinate the activities of regulatory agencies and curb any potential overlap issues; (3) certain regulations that pose problems need to be clarified or modified and (4) in order to produce an efficient and effective regulation, the regulatory framework should be tailored to specific legal and institutional standards.

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83 See Sub-section 5.3.4 for more detail regarding the finding.
7.2.3 Unfairness in regulation

The findings indicate that the unfairness in regulation influences tax compliance and it is a factor that prevents the tax authority from earning taxpayers’ trust as the regulation is perceived as favouring the interests of the DGT.\textsuperscript{84} This is consistent with previous research that found unfairness in regulations may undermine trust in government (Guerrero, 2011; OECD 2004; Sunshine & Tyler, 2003; De Mello, 2008; Mascagni et al., 2014; van der Hel-van Dijk-van Dijk & Siglé, 2015). The OECD (2004) claimed that an escalating risk of non-compliance is the result of unfairness in regulations and the inappropriate way in which they are applied. Several elements of fairness are identified as fundamental factors influencing compliance. Factors such as distributive justice, procedural justice, retributive justice, horizontal equity, and vertical equity have been considered as crucial aspects of equity that shape compliance (van der Hel-van Dijk-van Dijk & Siglé, 2015). Moreover, Sunshine and Tyler (2003) argue that the taxpayers’ perceptions of unfairness in regulations undermine their compliance with the law. Interestingly, in an experiment using newspaper stories, Nadler (2002) found that the exposure of unfairness in one set of laws such as the tax laws increased the willingness to violate other unrelated laws. Therefore, taxpayers might comply with tax laws or decisions by the tax authority when these have been established after deliberations that are perceived as procedurally just and not unfair, even when the outcomes are unfavourable to them.

Next, taxpayers’ trust in government may further diminish as the unfairness continues. An ideal regulation is one that is neutral, fair, and accommodates both the taxpayer and the tax authority. Furthermore, regulatory quality and the conduct of the law also have a positive effect on trust in the government (De Mello, 2008). In developing countries, poor trust in the authority and the inconsistent application of regulations are two problems in a vicious cycle as they produce low compliance because they generate confusion and uncertainty (Mascagni et al., 2014). This confirmed the World Bank concern that the public perception of the tax authority never been regarded high if the situation surrounding taxpayer compliance issue was not fully anticipated, in

\textsuperscript{84} See Sub-section 5.3.3 for more detail regarding this finding.
contrast, it may undermine the legitimacy of the government if wrongly anticipated (Guerrero, 2011).

7.4 The DGT’s current capacity to respond

Section 7.4 discusses findings regarding the DGT as the institution that has the capacity to respond to the corporate tax compliance issue. There are three themes that will be further elaborated in relation to the previous studies: (1) human resources issue, (2) lack of access to data, and (3) administrative weaknesses.

7.4.1 Human resources issue

The findings reported in subsection 6.2.1 indicate that there are at least three major issues in the DGT that are related to the human resources problem. The problems are (1) corruption and lack of integrity; (2) lack of professionalism; and (3) lack of sufficient human resources.

7.4.1.1 Integrity and corruption

The findings indicate that, although the overall integrity of tax officials is better now than it was in the pre-modernisation era, the issue of corruption still exists. There are many studies that have investigated the relationship between corruption and tax compliance (e.g. Flatters & Macleod, 1995; Picur & Riahi-Belkaoui, 2006; Bird et al., 2008; McKerchar & Evans 2009; Bird & de Jantscher, 1992; Rosid et al., 2016). These previous studies in general, argue that corruption has a negative impact on tax compliance, which is consistent with the findings reported in this subsection. However, it is worth noting that many participants agreed that the integrity of the DGT’s officials was much improved since the era of pre-administration reform in 2002. Nevertheless, the improved integrity of the DGT’s officials does not seem to have had an impact on compliance since the overall level of corruption in the other institutions outside of the DGT remains high. The latest data from Transparency International shows that Indonesia is the ninetieth least corrupt nation out of 175 countries.

85 See Sub-section 6.2.1.1 for more detail regarding the findings.
86 According to the 2016 Corruption Perceptions Index, Corruption Rank in Indonesia averaged 100.27 from 1995 to 2016, reaching an all-time high of 143 in 2007 and a record low of 41 in 1995.
study by Rosid et al. (2016) provides sound evidence that corruption has a negative impact on tax compliance in Indonesia. Therefore, the work of alleviating corruption should be aligned with that of other government institutions. Otherwise, a higher continuous compliance level with a better voluntary compliance is merely an illusion.

7.4.1.2 Lack of professionalism

The findings indicate that DGT officials lack professionalism due to the combination of three major factors: power abuse, bias when interpreting the law, and the pressure of achieving the revenue target. This is consistent with the previous research finding that the professionalism of tax officials responsible for law enforcement can significantly reduce non-compliance (Baer & Silvani, 1997; Braithwaite & Wirth, 2001; Lushi, 2016; Höglund & Nöjd, 2014). This lack of professionalism is considered to be one of the major obstacles facing tax administration in developing countries that needs to be addressed in order to increase voluntary compliance (Baer & Silvani, 1997). Further, Braithwaite and Wirth (2001) suggest that the tax administration should monitor taxpayers’ reactions to the professionalism of its tax officials in order to ensure appropriate procedural justice. The way in which officials communicate with taxpayers also needs attention since unprofessionalism in communication will harm the public’s perception of the organisation and psychologically disturb taxpayers (Höglund & Nöjd, 2014), and it may convey the impression to taxpayers that officials are abusing their power. In addition, in the case of Indonesia, there is the unique situation where the revenue target is alleged to be one of the obstacles to professionalism. The achievement of the revenue target by the end of the financial year is used as a crucial performance indicator against which an official is evaluated (Widihartanto & Braithwaite, 2016). Achieving it could mean promotion and failing it could mean otherwise. As indicated by the findings, the pressure to achieve the revenue target causes officials to behave unprofessionally, abuse their power, or make a biased interpretation of the law in order to boost their performance. Therefore, the tax authority administration needs to carefully address the officials’ lack of professionalism as the root of the problem may have nothing to do with the officials’ personal capability.

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87 Recall Sub-section 6.2.1.2 for more detail regarding the findings.
7.4.1.3 Lack of adequate human resources

The findings show that the DGT has inadequate human resources in terms of both quantity and competence. This supports past research showing that the discrepancy between the reality and what the organisation needs is a classic problem of tax authorities in developing countries (Baurer, 2005; Gallagher, 2005; Baer & Silvani, 1997; Muhammadi, Ahmed & Habib, 2016; Widihartanto & Braithwaite, 2016). In regard to the number of staff, Gallagher (2005) argues that the optimal proportion is about one tax officer per 1,000 people. Considering Indonesia’s population size, Indonesia has consistently failed to meet the optimal proportion since 1963 with 0.04, 0.12 in 1982, 0.14 in the mid-1990s (Korte, 2013) and the latest ratio in 2016 remains unchanged at 0.1417 (37,000 tax officers) for a population of about 261.1 million people (DGT, 2016). Figure 7-1 below illustrates the population to staff ratio of selected countries in the Asia-Pacific region in 2011. This figure demonstrates that the number of tax officers in Indonesia is far from ideal even when compared with its neighbouring ASEAN countries where only Myanmar and the Philippines have a worse ratio. Moreover, as shown in Figure 7-1, Australia and New Zealand have closer to the ideal ratio in terms of the optimal proportion.

![Figure 7-1 Ratio of Population to Tax Officers, 2011](image)

Source: Modified from the Araki and Claus (2014)

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See Sub-section 6.2.1.3 for more information in relation to the findings of the factor lack of adequate human resources.
In regard to the competence of officials, a study undertaken by Muhamaddi et al. (2016) demonstrates that the DGT’s auditors lack the competence to deal with transfer pricing cases. They argue that this incompetence is the result of the DGT’s policy to not have dedicated auditors to handle transfer pricing cases. Moreover, the rigid mechanism of rotation of staff is blamed as the cause of this incompetence since the most knowledgeable person does not always work on the transfer pricing case, and it takes a long time to train a new auditor to handle transfer pricing cases. Further, the issue of incompetence due to a lack of knowledge, as indicated in the findings of subsection 6.2.1.3, apparently prevents the organisation from determining the actual scale of large business compliance. One participant who was a high-ranking tax official admitted that the auditors’ lack of technical skills was a huge problem in the organisation. This assertion seemed to be supported by the findings since some interviewees, who were the auditors in a large taxpayer office, surprisingly, also admitted that they had never found any issue related to tax planning or tax avoidance during audit. Hence, these findings confirmed Baurier’s (2005) assertion that a typical characteristic of tax administration in developing countries is that the number of staff and their skills level were inadequate for the requirements of their organisation, and staff lacked specialised knowledge of a particular tax-related area. However, it should be noted that a similar situation where there is a mismatch in tax skills and knowledge among tax officers, tax advisors and tax managers may exist as well in developed countries although the severity is lower than a developing one.

7.4.2 Poor data management

The findings show that the factor of poor data management has dire consequences on the DGT’s capacity to handle tax non-compliance. Some scholars recognise that poor data availability and its ineffective management is one of the fundamental challenges of tax administration in developing countries (Tanzi & Zee, 2000; Baer & Silvani, 1997; Torgler, 2003; Kidd & Crandall, 2006). As asserted by Tanzi & Zee (2000), many developing countries face formidable challenges when attempting to establish an efficient and effective tax system and one of the major impediments is the paucity of qualified data management experts to support the operations of the tax administration. Moreover, poor data management prevents the control of non-

89 Recall Sub-section 6.2.2 for more detail regarding the findings.
compliance and leads to poor coordination between the taxation agency and other agencies (Baer & Silvani, 1997). For example, poor communication and poor data exchange prevents the agency from establishing an effective tax administration (Kidd & Crandall, 2006).

The DGT has recognised this problem and has started to align the audit with its related risks. They commenced the program of mapping, profiling and benchmarking to assess the financial ratios of more than 30 business sectors in order to determine the fair tax share of a particular company relative to its counterparts. If there is an unreasonable discrepancy, a further investigation is carried out. By integrating these data in the data-matching information system, the DGT has attempted to minimise tax evasion and make it easier to detect tax manipulation. However, the overall progress of an integrated computerised tax system was halted after the PINTAR project was postponed as the DGT had problems in fulfilling prerequisites determined by the international donors (Korte, 2013). Besides, the obstacles were also produced by factors external to the DGT, such as the difficulty of accessing banking data because of bank secrecy laws and the reluctance of other domestic agencies to share their data. Meanwhile, domestic sources of information are becoming a vital part of tax administration, and the national legislation plays a role in ensuring its effectiveness (McCracken, 2002). Therefore, poor data management is a symptom of fundamental deficiencies in the tax administration system, and it hampers the effectiveness of the revenue institution to respond to tax non-compliance. Therefore, this concern should be addressed by the government in order to improve fiscal performance.

7.4.3 Poor internal coordination

The related findings indicate that poor internal coordination is considered to be one of the major problems of the DGT, hampering its administrative competence. Previous studies have reported similar findings: that a competent administration plays a vital role in the success of tax administration; moreover, it has become a significant issue in

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90 PINTAR is a large-scale, stand-alone project drafted by the World Bank and the Indonesian government with the purpose of automating and integrating the Indonesian tax administration systems. One of its major aims is to improve the efficiency of taxpayer data management and its tax collection (World Bank, 2008).
91 See Sub-section 6.2.3 for more information regarding the finding.
developing countries (World Bank, 1999; Shaw, Slemrod & Whiting, 2010; Kidd & Crandall, 2006; Tanzi & Zee, 2000, Baer & Silvani, 1997). A competent administration obviously plays a significant role in determining the success of the tax authority’s operations. However, the issue of a competent administration has been mostly overlooked in terms of tax policy formulation in many countries, especially in the developing ones (Shaw et al. 2010). Further, the World Bank (1999) explicitly stated that developing countries have a severe issue with appropriate and effective tax administration and, therefore, it is imperative that the dynamics of tax administration be thoroughly understood by the relevant decision-maker (Bird, 2004).

Regarding the finding presented in this subsection, the challenge of internal coordination cannot be underestimated since the geographically-dispersed nature of many tax offices across Indonesia constitutes a major obstacle. Second, the strong pressure to achieve the revenue target and the ‘sectoral ego’ among tax offices has led to the reluctance to share information perhaps at the cost of not achieving the overall goal of the organisation. Nevertheless, the issue of poor internal coordination confirmed Baurer’s (2005) observation that the poor coordination among internal units and other related government agencies is a glaring issue for tax administration in developing countries.

7.5 Managing non-compliance

The findings show that the DGT manages large business non-compliance by means of two general approaches: persuasiveness and law enforcement.92 This is in-line with the DGT’s 2015-2019 strategic map where the DGT has identified two strategic objectives regarding tax compliance: ‘better services’ and ‘effective enforcement’ (DGT, 2016). The ‘better services’ refers to the DGT’s aim to improve its service excellence, the effectiveness of public relations, and the dissemination of targeted information. Meanwhile, the ‘effective enforcement’ refers to the improvement of the taxpayer monitoring program, the tax audit process, and law enforcement.

However, it is worth noting here that, to date, the DGT does not have a specific program tailored to anticipate large business non-compliance as other countries have.

92 See Section 6.3 related to the findings of managing non-compliance for more information.
The abovementioned approach is a generic treatment of non-compliance regardless of the type of taxpayer - whether it is an individual, small firm or large business. Further, the DGT does not have a formalised strategy regarding compliance risk management for the taxpayer. The lack of a comprehensive, risk-based management approach prevents the DGT from effectively allocating resources and treating taxpayers appropriately according to their risks. Consequently, several important decisions were made subjectively rather than being based on a systematic approach. The lack of an efficient approach has led to a poor understanding of the true nature of taxpayer compliance behaviour. However, a tighter control over large taxpayers actually began with the start of the modernisation program in 2002. The initiative of large tax offices with the aim of increasing revenue by tightening the control over large taxpayers and tax officials alike (Brondolo et al., 2008) could be considered as a part of the anticipation measure that would maintain large business tax compliance.

Nevertheless, recognising the urgency of the situation, the DGT included the initiative of compliance risk management (CRM) program in its 2015-2019 strategic maps (DGT, 2016). The pilot test of the risk engine of CRM was commenced in 2015 with the aim of collecting taxes fairly based on a risk-based compliance model approach. The expected outcome was a mapping of the effective taxpayers’ compliance according to their risk and their fiscal importance. Further, the accurate anticipation of and the appropriate response to non-compliance risks were also expected outcomes.

The OECD (2009) documented the experiences of eight countries in dealing with large business compliance. The report demonstrates that overall, there are several key issues and activities required to improve large business compliance: (1) strategies and programs to build a better relationship with taxpayer, (2) commencement of real-time management approach, (3) the importance of corporate governance, (3) an enhancement of the organisation capacity, (4) performance measures, (5) effective rule and policy, (6) adequate information and technology.

Therefore, given the current capability of the DGT and with regard to the factors that influence large business compliance, it is obvious that the authority should address several fundamental problems before applying an effective measure to address large business non-compliance based on the ‘best practice’. A more detailed discussion of
the policy implication for the management of large business compliance is presented in Section 7.7.

7.6 Responsive regulation as an alternative

The findings indicate that cooperative compliance based on the concept of responsive regulation is perceived by many participants as applicable to the policy formulation of the DGT to handle the compliance problem of large business. The adoption of the responsive regulation principle for compliance risk management has become a new means by which tax administration can improve compliance, particularly in the developed countries (OECD, 2004; EC, 2006). One of the main reasons for the adoption is the importance of understanding taxpayer behaviour. This measure is able to provide the most effective response to taxpayers according to their level of compliance given their available resources (EC, 2006).

The DGT, on the other hand, focuses on the conventional command and control approach, using penalties and tax audits either to deter non-compliance or to enforce compliance (Arnold, 2012). This conventional method with its emphasis on coercion has been criticised for its ineffectiveness as it should be combined with other measures in order to improve compliance (Braithwaite, 2002). Ayres and Braithwaite (1992) propose the concept of responsive regulation that focuses on persuasion rather than enforcement as a means of managing compliance risks and improving voluntary compliance. The OECD (2001) suggests that a systematic design should be adopted by tax administration with the incorporation of risk management based on responsive regulation to enhance voluntary compliance as this design is more effective than relying solely on deterrence. Further, Braithwaite (2006) argues that this approach is more attractive for developing economies which tend to have more limited resources. Hence, McKerchar and Evans (2009) suggest that a synchronised and coordinated plan with multiple intact policy instruments and supported by a robust policy regulation policy are necessary for the developing countries in managing their compliance strategy.

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93 See Section 6.4 for more detail regarding the findings.
94 See Section 3.4 for the details of the concept regarding responsive regulation.
However, the implementation of a new policy requires an understanding of the local context. Learning from the officials, taxpayers and advisors could produce knowledge on how policy should be adapted in different circumstances. Therefore, as indicated in section 6.4, several participants argued that the DGT should first meet the prerequisites condition before implementing the new policy. Next, several issues must be rectified in order to have a better outcome. The issue of fairness and trust, respecting the taxpayer’s rights, consistency of application, compliance measurement, and a rewards and punishments scheme are some of the emerging issues that should initially be considered by the DGT.⁹⁵

Besides learning, the rigidity of the DGT’s administration structure could be an obstacle to the implementation of a new policy. Rigidity means that the practices of tax administration are not adjusted to support ‘regulatory innovation’ (Black, Lodge & Thatcher, 2005) and experimentation (Dorf & Sabel, 1998). Secondly, the revenue target that is governing the tax system in Indonesia may place constraints as this overarching issue has become entrenched in the mindset of the tax officials (Lerche, 1980). Several participants confirmed that the factor of revenue target had compromised the officials’ professionalism when discharging their duties, and has consequences for the perception of fairness and trust, two crucial factors required in order for responsive regulation to be effective.

Therefore, compliance risk management based on the responsive regulation concept is regarded by many scholars as a better approach for tax administration to enhance compliance. Several countries that have applied this concept are evidence of its value. However, the terms and prerequisite conditions should be met before carefully introducing a new policy into the existing system.

7.7 Research questions reviewed

Having discussed the findings regarding the factors that influence large business compliance and the responses from the related tax authority, this section discusses the answer to the research questions proposed in this thesis:

⁹⁵ See section 6.4 for details of the issues that need to be rectified.
RQ1: What are the factors that influence large business taxpayers’ compliance risks from the perspectives of the tax officials, the tax managers, and the independent tax advisers?

RQ2: How does the tax authority manage large business taxpayers’ compliance risks according to the factors identified by addressing the previous research question?

7.8.1 The factors that influence large business tax compliance in Indonesia

This study demonstrates that the findings regarding the corporate factor consist of three major compliance risk factors: economic factor, sociological considerations, and corporate characteristics (as indicated in Section 5.2).

First, the economic factor was affected by five aspects that influence corporate tax compliance. They were: cost-benefit-driven decision, bonus for manager, probability of detection and penalties, risk appetite and uncertainty. The cost-benefit-driven decision was most likely to affect the large businesses’ decision regarding the formulation of a tax planning method since the corporation is seen as a rational economic animal that always makes thorough calculations. Participants considered that of the bonus offered to a manager was a factor that only slightly affects corporate tax compliance in Indonesia. The probability of detection and penalties that is generally regarded as a significant factor influencing compliance, surprisingly to some extent was not viewed by some large businesses as a factor that can make them more compliant. Regarding risk appetite, the level of a corporation’s risk appetite was determined by the size of the company and its closeness to one or more influential persons in the country. Meanwhile, uncertainty is created when the taxpayer receives non-standardized treatment from tax officials.

Secondly, three sociological aspects influence the level of compliance. They are: personal norms, social norms, and the aspect of fairness and trust to government. Personal norms are considered to have an influence on corporate tax compliance since the personal norms of the firm’s manager would influence his/her company, and the cultural factor comprising thoughts, customs, beliefs and nationalities was found to influence corporate tax compliance. Here, social norms are related to the issue of
corporate reputation, and it was found that corporate reputation was a priority and had to be maintained. However, the consideration of business profitability might cause some large businesses to overlook the reputation issue. The aspect of fairness and trust in the government was found to affect compliance if the taxpayer felt mistreated by the authority, and this would influence the taxpayer’s willingness to pay taxes.

Finally, four corporate characteristics were considered to have an influence on compliance. They were: tax risk management, ownership structure and business size, business profitability and the use of a tax advisor. The importance of having a good tax risk management strategy to ensure corporate tax compliance was acknowledged by participants, yet it was found that many large businesses did not support an adequate tax risk management function in their corporation’s tax department. Regarding the ownership structure and business size, it was found that the listed companies were perceived as having better compliance than the non-listed companies. Moreover, the nature of a business and the complexities of the business structure were also perceived as having an influence on corporate tax compliance. Business profitability affects the corporate tax compliance at the time of adversity and in the situation where the company opted in using their money for something else rather than paying taxes because of profitability consideration. Meanwhile, the use of a tax advisor can have either a positive or a negative effect on compliance depending on the type of service or advice that is being delivered, and on the tax advisor’s integrity.

The findings show that the weaknesses in regulations were considered as significant risks that influence compliance (as described in Section 5.3). Specifically, the weaknesses in regulation were caused by three major issues: the ambiguity in the wording of regulations, the uncertainty produced by regulations, and the regulatory overlap.

First, the issue of ambiguity in regulations leads to multiple interpretations which may cause disputes between the taxpayer and the tax authority and, moreover, may lead to a conflict among government agencies. Consequently, the tax authority will be less accurate when executing what is required by law.
Second, uncertainty is related to the unpredictable behaviour of officials and is related to the issue of the clarity of regulations. Unpredictable behaviour is the result of insufficient expertise, loosely-applied standards and ineffective oversight, or a combination of these factors so that the actions of officials are often ad hoc and arbitrary.

Third, the regulatory overlap is caused by inconsistency among the laws that have overlapping regulations regarding the same issue. Further, inconsistency occurs vertically which means there is inconsistency or even contradiction between the law and its sub-laws, and it also occurs horizontally which means conflicted between the laws for a particular object. Also, regulatory overlap is caused by the poor coordination among government institutions.

Lastly, the unfairness inherent in regulations influences taxpayer compliance and is a crucial factor as it prevents the DGT from earning the trust of the taxpayer.

In conclusion, the findings reported in Chapter 5 indicate that there are two dominant factors that influence tax non-compliance of large business in Indonesia: the corporate factors and the regulation factors.

7.8.2 The response of the DGT in managing compliance risks of large business

The finding indicates that the tax authority in Indonesia manages the compliance risks of large business by using two approaches: persuasiveness and law enforcement. Persuasiveness is the soft measure applied after the taxpayer has been monitored by the Account Representative. Subsequently, a letter asking for clarification is sent to the taxpayer, or a counselling session with the taxpayer is organised. Normally, law

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96 Recall Section 6.3 for more detail.
97 Counselling refers to a practice used by DGT to clarify any discrepancy found in the tax return using external data. In this process, it is possible that the taxpayer would agree with the DGT’s findings and pay the additional tax owed or defend his position by providing an explanation and evidence with regard to the discrepancy. With the latter condition, DGT can accept the taxpayer’s explanation and close the case or refuse the taxpayer’s explanation and ask the taxpayer to pay the tax owed. If taxpayers refuse to pay the tax owed in this counselling stage, then this process can be escalated into auditing or investigation depending on whether or not there is an element of criminal offence in the case.
enforcement is applied as the hard measure if the first procedure has failed. This hard measure involves an audit or an investigation in the case of a tax crime.

However, it is worth noting here that the DGT’s ability to detect non-compliance is strongly related to the effectiveness of the action taken by the organisation in managing the issues. The finding presented in sub-section 6.3.1 indicates that the tax authority’s inadequate ability to detect non-compliance is caused by the lack of sufficient information, the ineffective mechanism of information exchange, and the pressure of the revenue target.

7.9 Chapter summary

This chapter discussed the findings obtained from the qualitative data analysis elaborated in Chapter 5 and Chapter 6. The findings are related to the existing literature and are intended to address the research questions established for this thesis.

In principle, the findings support the existing literature with some exceptions. In general, the economic factors, socio-psychological factors and corporate characteristics affect large business tax compliance in Indonesia. The regulation factors are presented separately in this thesis since several aspects of the laws and regulations are beyond the reach of large business and the tax administrators. The complexity, ambiguity and unfairness of regulations, together with regulatory overlap, are some of the regulation issues that affect large business compliance. Some exceptions related to the factors that affect influence compliance are found in this thesis. For example, the compensation of the tax manager is not regarded as significantly influencing compliance because the role of the tax division in a corporate structure is under-rated. Moreover, the issue of a revenue target in Indonesia could be categorized as a new perspective of the factor that influences compliance since this issue either directly or indirectly affects the quality of treatment of the taxpayer.

The response of Indonesian authorities when managing the compliance risks associated with a large business is evidently far from ideal. The capacity of the DGT to detect non-compliance is below average due to inadequate human resources, poor data
management and inefficient internal coordination. Moreover, the conventional policy that relies heavily on tax audits and sanctions to prevent large business non-compliance is considered to be ineffective in the current situation considering that several other tax administrations have switched their policy into the cooperative compliance. However, it is worth noting that there are several prerequisites that should be met by the DGT before introducing a new policy into their operations.

Chapter 8 which follows includes the summary of this thesis and its key findings, policy recommendations, its contribution to the literature, its limitations, and future research directions for the study of tax compliance.
CHAPTER 8
CONCLUSIONS AND POLICY RECOMMENDATIONS

8.1 Introduction

This chapter has seven sections which conclude the thesis. Section 8.2 provides the summary of the study and its major findings. Section 8.3 discusses the contribution of the thesis to the literature, while section 8.4 offers policy recommendations to the Indonesian government based on the findings of this study. The limitations of this study are acknowledged in section 8.5, followed by suggestions for potential future directions of compliance study.

8.2 Summary of the study

This study investigated the factors that influence large business tax compliance risks from the perspectives of tax officials, tax managers and tax advisors. This study also investigated the response of the Indonesian tax authority in managing those compliance risks. For this purpose, this study began with an overview of the tax administration situation in developing countries and the challenges faced by those countries in managing taxpayers' compliance. The situation in Indonesia where large businesses are registered and required to fulfil their tax obligation is presented in Chapter 2. This provides the contextual background and description of the contemporary tax collection situation in Indonesia. The chapter also discusses the compliance issues, in particular the issue of tax avoidance by large businesses.

It was found in Chapter 3 that the tax compliance behaviour of large businesses is complex and involves multi-disciplinary subjects; therefore, an understanding of the concept of tax compliance that includes tax avoidance and tax risk is necessary since there is no single accepted definition for those concepts. For this reason, it was considered essential to determine the concepts of relevance to this study that were offered in the body of literature. It was concluded that tax compliance could be categorised according to the conceptual and practical definitions. The conceptual definition emphasises the willingness of taxpayers to comply voluntarily, while the
practical one focuses on the administrative fulfilment of taxpayer obligations. In terms of tax avoidance, it was implied that the avoidance situation occurs when taxpayers are taking advantage of loopholes in the tax law where the degree of the avoidance severity ranges from the legal action to the illegal one. In terms of tax risk, it was concluded that both taxpayer and tax authority have their own definition of tax risk. Taxpayers tend to view tax risk as the likelihood of an unexpected outcome from a particular tax position, while the authority defined tax risk as the likelihood of taxpayers engaging in activities that potentially have impacts on the collection of revenue.

It was recognised in the study that to some extent, corporate and individual compliance have many characteristics in common as a corporation is an entity that consists of employees and managers who determine the corporation’s behaviour. It was acknowledged that there were three categories of factors influencing corporate tax compliance: economic factors, socio-psychological factors and corporate characteristics. Further, the components of each main factor and their relationship with corporate taxpayer behaviour were discussed not only to provide an understanding of the concept, but also as a basis for the validation of the findings of this study.

The concept of responsive regulation and the CRM were reviewed in Sections 3.4 and 3.5. It was concluded that, generally, tax compliance could be encouraged by applying a soft compliance incentive rather than a deterrence incentive. The responsive regulation approach is considered to be a better enforcement strategy as it shifts tax enforcement from rigid deterrence to a dynamic framework that accommodates the interaction between the tax authority and taxpayers. This approach favours cooperation from the taxpayers and is aligned with the objective of the tax authority which is to stimulate an optimum level of voluntary compliance, and it is manifested as a regulatory pyramid that indicates the responsiveness to persuasion or punishment. Meanwhile, the OECD and European Commission suggest that the operations of CRMs should be based on the responsive regulation principle, and a five-stage iterative process for CRM has been suggested for the systematic management of compliance risks by the tax administration.

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98 See section 3.3 for more detail about the factors influencing corporate tax compliance.
It was argued that a developing country with limited regulatory capacity might benefit from the use of responsive regulation as the flexibility in the approach allows the tax administration to focus its enforcement on a specific target with higher revenue potential. Despite the criticism of its enforcement consistency, responsive regulation is considered to have several advantages over the conventional approach, deterrence, which is regarded as ineffective in encouraging voluntary compliance as well as incurring higher costs and consuming more resources, things that a developing economy lacks.

Since tax compliance is a social phenomenon that is shaped by many factors, it was then reasonable to argue that the adoption of a qualitative approach is the most appropriate for acquiring an in-depth understanding of large business tax compliance. Chapter 4 discussed in detail the research design and the methodology applied to achieve the objectives of the study. Accordingly, semi-structured in-depth interviews with purposive sampling were used in this study with 48 participants as key informants as part of the data collection process. Those participants were divided into three different groups according to their functions namely, tax officials, tax managers and tax advisors, and members of each group were further categorised according to their various positions within their respective organisations. For data analysis, a thematic analysis approach was used to analyse the collected information since this approach provides several advantages over other approaches regarding data analysis. To overcome the issue of reliability and validity for a qualitative study, this study applied techniques of data triangulation, member checking and disconfirming evidence. Further, the interview data was also validated with relevant archival public records to support the statements made by the interviewees.

In addressing the first research question of the factors that influence large business tax compliance, it was found that several factors dynamically do have an influence on large corporate taxpayers in Indonesia as presented in Chapter 5. Significant findings are summarised in the following table as below.

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99 See Table 4-5 at page 84 for more information.
<table>
<thead>
<tr>
<th>Category</th>
<th>Factors</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic factors</td>
<td>Cost-benefit driven decisions</td>
<td>• Large business is viewed as a rational economic organism, the actions of which are always determined by cost-benefit considerations.</td>
</tr>
<tr>
<td></td>
<td>Compensations of manager</td>
<td>• The finding is somewhat inconsistent with past studies that bonus-based packages are strongly related to tax avoidance.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• The reason is that the tax department in Indonesia has a non-critical role, merely supporting the administration while the bonus offered is based on a pre-determined formula.</td>
</tr>
<tr>
<td></td>
<td>Probability of detection and penalty</td>
<td>• The severity of the audit results as well as the penalty imposed makes taxpayers aware of their compliance responsibilities.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Not every penalty has an equally effective deterrent effect.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• There was a low probability that a taxpayer would be known for its tax planning misconduct.</td>
</tr>
<tr>
<td></td>
<td>Risk appetite</td>
<td>• The business size and its closeness to someone influential might affect the risk appetite level.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• The risk was lower if the firm kept its distance from the official.</td>
</tr>
<tr>
<td></td>
<td>Uncertainty</td>
<td>• This occurs because of the issue of misinterpretation and lack of consistent treatment from the officials for similar issues.</td>
</tr>
<tr>
<td>Socio-Psychological factors</td>
<td>Personal norms</td>
<td>• The personal attitudes resulting from thoughts, customs, beliefs and nationality were regarding shaped the manager’s norms.</td>
</tr>
<tr>
<td></td>
<td>Social norms</td>
<td>• The firm’s reputation is a fundamental element that needs to be maintained.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• No generally accepted notion regarding the issue of the importance of reputation over the firm’s profitability.</td>
</tr>
<tr>
<td></td>
<td>Fairness and trust</td>
<td>• Fairness and trust in government influence compliance where lack of trust applies not only to the tax authority but overall to other government officials.</td>
</tr>
<tr>
<td>Category</td>
<td>Factors</td>
<td>Remarks</td>
</tr>
<tr>
<td>--------------------------------</td>
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</tr>
</tbody>
</table>
| Corporate characteristics      | Tax risk management          | • A robust TRM strategy played a vital role in ensuring compliance.  
• Many large businesses did not support an adequate tax-related system in their business.  
• A cost-benefit consideration made a robust TRM as the low priority. |
| Ownership structure and business size |                             | • Listed companies were perceived to some extent as having better tax compliance.  
• The industrial sector to which a particular company belongs affects compliance.  
• MNCs that utilise tax havens were perceived to have a higher level of non-compliance. |
| Business profitability         |                              | • Financial constraints affect compliance.  
• The tax was considered as the least concern during times of financial hardship. |
| The use of tax advisors        |                              | • May have two opposing effects on compliance - either positive or negative.  
• The large firm may introduce a more aggressive tax planning strategy. |
| Regulation factors            | Complexity                   | • May result in tax officials taking unpredictable actions.  
• The unpredictability is a result of the combination of the lack of clarity in the regulation, insufficient expertise, a loosely-applied standard, and the tax authority’s inadequate and inefficient oversight. |
|                                | Ambiguity                    | • Makes the authority less accurate in executing what is required by the law and makes taxpayers not meet what the law requires.  
• The tax legislation in Indonesia is somewhat vague and contains many loopholes and contradictions. |
|                                | Unfairness                   | • The pro-DGT biased regulations prevent the tax authority from earning trust.  
• Revenue target is viewed as the main source of unfairness in regulations. |
|                                | Regulatory overlap           | • It creates a waste of resources.  
• It occurs because of conflicting regulations and lack of coordination. |
In addressing the second research question of this study regarding the response of the Indonesian tax authority in managing those compliance risks, it was found that in general, the DGT manages the issue of non-compliance using two sequential steps: (1) by sending a letter requesting clarification or by arranging a counselling session as part of the persuasion process, (2) by tax audit or tax investigation as part of the enforcement process.\textsuperscript{100} However, there are several issues that hamper the DGT’s effectiveness in managing large business non-compliance: inadequate human resources, lack of access to data and administrative weaknesses as discussed in Section 7.4.

Regarding the responsive regulation approach as an alternative policy formulation to handle the compliance problem, it was observed that the application of this approach might benefit both the tax authority and the taxpayer. However, its implementation requires an understanding of the local context as well as the fulfilment of prerequisite conditions in order to ensure that the new policy will run smoothly.

In summary, this study provides evidence of the behaviour of large businesses in Indonesia in terms of tax compliance and details the responses of the tax authority in managing tax compliance risks. This study has shown the factors presented in Table 8.1 can have negative influences on the tax compliance of large businesses. This study also shows that, to some extent, the response of the tax authority in Indonesia in managing the risk of non-compliance is inadequate and has room for improvement. The findings of the study are considered relevant to both policymakers and taxpayers.

8.3 Contributions to literature

The study has contributed to the body of knowledge on the subject of tax compliance, particularly large business behaviour, in a developing country, in a number of aspects that include the research method and its findings.

First, the methodological contribution made by this study is that it employed the qualitative interpretative approach as an alternative since tax research literature is currently dominated by quantitative empirical research which to some extent leaves

\textsuperscript{100} See Section 6.3 for more detail.
many puzzles and conflicting evidence. The qualitative study also offers more in-depth understanding of the tax compliance phenomenon.

Second, the research method applied in the study included the perspectives of interrelated actors who provided valuable information about large business tax compliance. These key informants made a significant contribution as past studies, to the best of the researcher’s knowledge, have yet to apply this technique for the study of large business compliance. The involvement of 48 participants that represented tax officials, tax managers, and external tax advisors with various positions and from diverse organisations, has enriched the understanding of large business behaviour dynamics from many angles, and provided a holistic picture of the problem being addressed.

Third, this study contributes significant findings to the body of knowledge. Using evidence from a developing country, Indonesia, several factors that affect compliance as reported in the literature were confirmed as influencing Indonesia’s large businesses. Moreover, the documentation on how a tax authority in a developing country manages the issue of non-compliance is offered in this study as most of the literature on tax authorities’ experiences comprises studies of developed economies. Further, this study offers a comprehensive picture of the real issues faced by large businesses and tax authorities as a reference to extend existing theories. This study also examined the responsive regulation approach as the current best practice in managing non-compliance to determine its suitability for a developing country.

Finally, this study has captured some of the reasons why large firms choose to comply or not to comply with taxation laws and regulations. This is especially important in developing countries where corporate tax revenue is more critical, and these nations have limited capacity to collect substantial revenue from other types of taxation.

8.4 Policy recommendations

The findings show that, as summarised earlier in Section 8.2, there are three main issues that impede the DGT’s internal capacity as the Indonesian tax authority to adequately respond to the issue of large corporate taxpayers’ compliance. The findings
relate to human resources, data management and coordination. Hence, this study offers several implications and policy recommendations for the DGT.

Regarding human resources, there are three documented significant problems that relate to this issue: integrity and corruption, lack of professionalism and lack of adequate human resources. As discussed earlier in subsection 7.4.1, the issue of corruption still exists although the overall integrity of tax officials is better than it was in the pre-modernisation era. The likelihood of the tax auditor being involved in corruption is greater than for any other personnel in the DGT as corruption emerges to be more the result of opportunities created by interested parties than something that appears by itself. Hence, an effective measure to tackle corruption needs to be established as corruption undermines the trust of taxpayers. The concept of neo-patrimonialism\(^{101}\) is a valuable reference as, to some extent in the Indonesian culture, an understanding of the power relation between patron and the institution is crucial for any successful institutional changes to occur. Moreover, the use of extensive media coverage could prevent the corruption of officials as anti-corruption measures could be broadcast and disseminated to taxpayers. However, the improved integrity of the DGT’s officials will not have an impact on taxpayers’ compliance if the overall level of corruption in other government agencies remains substantial. Therefore, the attempt to eliminate corruption should be in tandem with that of other institutions.

The lack of professionalism due to power abuse, bias when interpreting the law and the pressure to achieve the revenue target is mainly caused by the inappropriate application of revenue target policy. The revenue target system, which is the overarching principle as it governs the tax system in Indonesia, in fact, poses obstacles to change. The tax target system that has been entrenched in the mindset of the officials needs to be reassessed for its costs and benefits. In the world of tax target system where the ultimate goal is the achievement of revenue target rather than the improvement of taxpayers’ compliance, the application of this misled policy has serious consequences. The determination of tax collected target through a top-down process has resulted in the tax auditor who oversees the investigating of tax evasion

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\(^{101}\) Neo-patrimonialism is a term that originated from Shmuel N. Eisenstadt work (1973) to describe a system of social hierarchy where the real power does not always lie to those who hold the higher position, instead, the real power is owned by the actor whose with ultimate control of networks.
also having a target. Aside from the lack of professionalism as mentioned earlier, the other implication of the tax target system is the common practice of collecting the following year’s taxes in the current fiscal period due to harsher target pressure. Conversely, the tax office might face a morally hazardous situation by overlooking taxpayers’ non-compliance as it has already achieved its target and takes advantage of the situation by using its discretionary power to pursue ‘rent-seeking’ from taxpayers.

Regarding the inadequate human resources, the DGT faces a complicated situation as the organisation is dealing with a shortage of personnel, a lack of competence, and a rigid staff rotation mechanism. The DGT’s structure under the MoF provides little autonomy for the DGT to self-regulate with respect to human resources management. Hence, a new arrangement that includes adequate training for the auditing staff, allowing specialisation instead of general staff rotation, recruiting new talent that focuses on the long-term goal and more importantly, a refinement of the human resources management system, are worthy of consideration by policymakers.

Poor data management can be attributed to poor data availability, ineffective management and the absence of a reliable information system. Although the DGT has recognised the problem and has taken action to address the issue, the outcomes are still below expectations. As an institution that relies on data and information in order to perform efficiently, the DGT needs to aggressively seek the support of other institutions that can provide necessary information such as banking information, for example, so as to have a seamless collaboration. Secondly, a ‘de facto’ political will from the government is a must as it becomes one of the solutions to this issue since legislative adjustments must and can be made. The improvement of the tax audit system and the introduction of a single, reliable information system are keys to data management refinement in the DGT’s information system and should be prioritised.

As a chronic problem in developing countries, poor coordination is considered as one of the major problems of the DGT that hampers its administrative competence. The challenge of geographically-dispersed tax offices across the Indonesian archipelago, the pressure to achieve revenue targets and ‘sectoral-ego’ among tax offices have reduced

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102 See subsection 7.4.1.3 for detail of the problems.
the cooperation instead of building synergy among units of the DGT. The issue of this administrative incompetence, to some extent, has been overlooked in tax policy formulation, and thus, it is imperative that policymakers understand the dynamics of tax administrations as each one has its own characteristics.

As a regulator, the DGT is expected to implement several policies that would improve large corporate taxpayers’ compliance, aside from the internal improvements suggested above.

The findings of factors that influence large businesses’ tax compliance would provide a valuable contribution to improving taxpayers’ compliance, specifically in Indonesia. The DGT should realise that addressing non-compliance can no longer be done exclusively through an audit-based approach as the factors underlying taxpayer’s compliance behaviour are varied and complex, and unlikely to be resolved by audit only. Nevertheless, the tax audit remains a significant tool for handling non-compliance as it ensures that taxpayers are complying with the laws. In this regard, this study has found that the adjustment of audit strategy would have significant benefit as the findings pertain to the Indonesian context. By considering the findings when establishing an audit strategy policy, it is expected that the accuracy of non-compliance detection would be improved as it would sort out the large firms according to their compliance risks, for example, those with undisclosed high-risk transactions or arrangements or abnormally low tax payments in a specific situation.

However, although the development of a specific standardised tax audit strategy in the case of large businesses is necessary, it is recommended that the DGT have a flexible policy that encourages voluntary compliance. Acknowledging the significance of large businesses’ contribution to State revenue and working together to achieve common goals, are two primary examples of compliance strategy that can be applied. The introduction of a Taxpayers’ Charter would be a sign of goodwill from the DGT as its guidelines would indicate how the DGT interacts with taxpayers. Further, the Charter would signify that the taxpayers’ rights and obligations are taken seriously as it guides the DGT’s actions. Another strategy is to involve intermediaries such as external auditors and tax consultants to maintain taxpayers’ compliance within the acceptable level. Appointment of an external tax advisor may have two opposing effects, either to
encourage or discourage taxpayers to comply then an appropriate strategy to regulate these parties is critical as a safeguard for the DGT to ensure that the tax advisors will improve taxpayers’ compliance rather than assist taxpayer’s aggressive tax planning.

Moreover, the adoption of a responsive regulation approach is desirable as this approach emphasises cooperative compliance that encourages voluntary compliance. By implementing an approach that involves consulting and collaborating with taxpayers when managing their tax risks and minimising compliance costs, it is expected that taxpayers’ engagement in voluntary compliance would improve. Further, those large firms that have a sound tax risk management system and continuous communication of tax-related problems would be perceived as transparent with the intention to establish mutual trust. Consequently, a better relationship leads to less audit intervention that will save the DGT’s finite resources and improve certainty for both taxpayers and the DGT.

However, it is worth noting that there is no best practice, one-size-fits-all solution, and thus a system should be tailored according to the respective tax administration’s situation. Aside from the technical aspects of a new policy, an understanding of the principles underlying the new policy, the regulatory infrastructures, cultural background and institutional arrangements is necessary. Moreover, a consideration of the time required, prerequisite conditions, smooth communication and continuous dialogues with the participants, and effective strategies to handle not only the resistsants but also the embedded counterproductive culture within the DGT, are the elements that will determine the success of a newly implemented policy.

In summary, two major issues need to be resolved by the DGT in order to foster large business tax compliance in Indonesia; these are (i) an improvement of the DGT’s internal capacity to respond to non-compliance, and (ii) a sound strategy to regulate large business tax compliance. Further, this study suggests that all stakeholders should be informed about the changes that will occur, and the reform of institutions outside the DGT might be crucial as the weaknesses of institutions such as the general public administration system, parliament and the judiciary might hamper the DGT’s function as the State’s revenue collector.
8.5 Limitations

This study was designed to explain the large business tax compliance risk behaviour in Indonesia by using a qualitative method approach to capture the phenomenon comprehensively as required by the research objectives. However, it should be noted that several limitations of this study should be acknowledged. In this regard, the findings in the study should be interpreted with caution to ensure the accuracy of further research and the correct use of policy formulation.

The first limitation is related to the determination of the factors that affect large business tax compliance. This study was developed based on a number of past studies that cover many countries as well as different research methods. There is no a generally accepted way to determine the factors that influence compliance, and the exact relationship between large businesses tax compliance and their motive to either to comply or not comply is also unclear. Therefore, caution should be taken in interpreting the findings. Nonetheless, it is acknowledged that this study followed the study of van der Hel-van Dijk-van Dijk, and Siglé, (2015) in terms of the categorisation of factors in order to maintain the synchronicity and consistency of tax research.

The second limitation relates to the sample which included tax managers employed by large businesses in Indonesia. While to some extent, these participants’ responses were valuable indications of their respective organisations’ behaviour, a question such as “What makes your company pay taxes?” may elicit a biased response as the participants have different behaviour as an individual that affect their perspectives accordingly. Moreover, the sample included large corporate taxpayers in Indonesia, so the findings cannot be generalised to other countries and contexts. Other countries may have different non-compliance intentions and behavioural characteristics that may influence the outcomes, although it is believed to some extent the findings of this study are expected to have relevance in other jurisdictions.

The third limitation is this study’s reliance on interviews as a source of data. As this method relies on participant’s responses to the questions, the quality of the answers may be affected by the participant’s ability to accurately and honestly recall and express experiences, thoughts, opinions or behaviours that, moreover, might also be
affected by emotional strain. The boundaries would include the notion that tax is regarded as a sensitive issue that may cause discomfort to participants and prevent them from answering honestly and accurately. Furthermore, in terms of transforming the raw data from the interview into accessible information, the possibility of inconsistency, inaccuracy and subconscious bias might occur, and although several precautions were taken to minimise the issue, there is potential for disparity between the original and the final data.

The fourth limitation is related to the amount of corporate tax compliance literature that is available. As an area of study that has burgeoned in recent years, tax research on corporate taxpayers alone has outperformed other tax research areas more than six-fold (Feller & Schanz, 2014). Therefore, it was not feasible to locate and review every available reference due to resource and time constraints. As a consequence, most of the literature reviewed in this study was published in English. Hence, relevant works published in other languages may have been overlooked, and the effect of this omission is unknown.

Nevertheless, feasible precautions have been taken in the study to minimise the identified limitations. In addition, most of the acknowledged limitations are inherent to this type of research and are therefore inevitable; these limitations should not lessen the value of the study as appropriate measures have been applied to ensure validity and reliability.

8.6 Suggestions for future research

Tax compliance is a vast topic, and there is no single study that is able to generate a comprehensive understanding of every aspect of the issue despite ongoing and ample research conducted in recent years. It is especially true in relation to the situation of tax administration in developing countries where a significant improvement in taxpayer compliance is most needed. Therefore, further studies on the subject of corporate tax compliance are necessary to address gaps in the body of knowledge.

The aim of this study was to investigate the factors that influence large businesses tax compliance risks in Indonesia and the responses of the respective tax authority in
managing those risks situation. Future research could consider a non-qualitative approach to measure and determine the relationship between factors. This would enable a more comprehensive comparison of the research outcomes and provide a better understanding of large business behaviour toward taxation. For example, studies emphasising tax savings restricted to the sector of the economy. A wider coverage of participants or respondents also could be included in future research in order to capture the voice of a wider population as this would provide a more complete explanation of the large business behaviour phenomenon.

Future research could also explore the factors that influence large businesses’ tax compliance in other developing countries as this study’s findings apply only to the Indonesian situation. Most of the previous studies on taxation compliance have been conducted in developed countries. The theories that have emerged from these studies can be extended and enriched with similar studies in developing countries, thereby offering a more comprehensive picture of large business compliance.

Another improvement could be made by investigating the outcomes achieved by other tax authorities in other developing countries when managing large businesses tax compliance risks. Further, future research could propose better strategies that are more appropriate for developing countries. For instance, the experiences of other developing countries in adopting compliance strategies can be compared and adopted to generate better strategies. Further taxation studies are also needed to validate the findings of this study as they would complement and enrich the understanding of large businesses’ behaviour regarding their tax compliance.

8.7 Concluding remarks

The study of large businesses’ tax compliance is especially important for Indonesia, because of the volume of tax revenue which is collected from large corporate taxpayers. A better understanding of large businesses’ behaviour in a developing country would contribute not only to the body of knowledge but also more importantly to the policymakers in the respective country to improve their strategies for large corporate taxpayers. This study investigated the factors influencing large businesses’ compliance risks in Indonesia and how the respective tax authority
manages these risks. It is anticipated that this study will offer a better understanding of the motives and behaviours of large business in regard to taxation, and the parallel experiences of the tax authority in a developing country. Moreover, it is expected that the findings derived from this study will enable those who are concerned with large corporate taxpayers' compliance to establish sound strategies to anticipate the more aggressive attempts by taxpayers to avoid compliance, and to improve voluntary compliance with the ultimate objective of improving public welfare.
Reference List


Blanthorne, C., & Kaplan, S. (2008). An egocentric model of the relations among the opportunity to underreport, social norms, ethical beliefs, and underreporting behavior. Accounting, Organizations and Society, 33(7-8), 684-703.


Pope, J., & Susila, B. (2014). Why the tax compliance costs of large companies in Indonesia are low compared to other countries: empirical evidence. *Australian Tax Forum*, 29(1).


Appendices

Appendix A
The hierarchy of rules and regulations in Indonesia

In addition, Presidential Instructions and Decrees, Ministerial Decrees and Circulation Letters are recognised as which add further detail to Laws and Government Regulation.

Source: Article 7 of Law No. 12 of 2011 on the Formulation of Law and Regulations
Appendix B
The DGT's organisational structure

Source: DGT (2017) p. 34. (Modified)
Appendix C
Interview questions

A. Tax officials
1. What is your assessment of the large business compliance behaviour? In terms of large business tax noncompliance, is there any major issue at stake?
2. If a company is not complying with the tax law, what are the factors that may cause of this noncompliance?
3. Currently, what is the approach of the Tax Office to anticipating these noncompliance risks?
4. If a taxpayer contravenes the tax law, how does the tax office manage this noncompliance taxpayer?
5. What is your assessment of the responsive regulation approach?

B. Tax managers
1. What factors do you think are the most significant for your organisation’s compliance:
   a. The tax structure, for example, tax rate, audit likelihood and tax sanctions or,
   b. The quality of tax administration, for instance, the level of trust and the level of service?
2. To what extent is your company’s reputation significant? Is there any legal issue about tax compliance between your company and the tax office?
3. Who has the final authority to decide tax matters in your company? Does this person take full responsibility for any dispute occurring between your business and the Tax Office? What is the potential downside if the company is unsuccessful in litigation with the Tax Office?
4. What is your assessment of the responsive regulation approach?

C. Tax advisors
1. What is your assessment of the large business compliance behaviour? In terms of large business tax noncompliance, is there any significant issue at stake?
2. Are there some factors that may prevent large companies from complying? What factor is the greatest risk to tax compliance?
3. Should the tax authority differentiate its treatment according to a taxpayer’s commitment to compliance? For example by imposing stricter penalties to those repeatedly committing infringements and otherwise by providing incentives to those who always comply with tax regulation.
4. What should the tax office do to obtain a better compliance by the corporate taxpayer?
5. What is your assessment of the responsive regulation approach?
Appendix D
RMIT Business College Human Ethics Advisory Network Approval

Notice of Approval

Date: 12 May 2015
Project number: 18984
Project title: Investigating Income Tax Compliance Risks of Large Businesses in Indonesia
Risk classification: Low Risk
Chief Investigator: Professor John Glover
Other Investigator: Professor Steven Deliaptas
Student Investigator: Mr Mochammad Hadi Pratomo
Project Approved: From: 5 May 2015 To: 3 March 2018

Terms of approval:

Responsibilities of the principal investigator:

1. Amendments
   Approval must be sought from BCHEAN to amend any aspect of a project including approved documents. To apply for an amendment submit a request for amendment form to the BCHEAN secretary. This form is available on the Human Research Ethics Committee (HREC) website. Amendments must not be implemented without first gaining approval from BCHEAN.

2. Adverse events
   You should notify BCHEAN immediately of any serious or unexpected adverse effects on participants or unforeseen events affecting the ethical acceptability of the project.

3. Participant Information and Consent Form (PICF)
   The PICF must be distributed to all research participants, where relevant, and the consent form is to be retained and stored by the investigator. The PICF must contain the RMIT University logo and a complaints clause including the above project number.

4. Annual reports
   Continued approval of this project is dependent on the submission of an annual report.

5. Final report
   A final report must be provided at the conclusion of the project. BCHEAN must be notified if the project is discontinued before the expected date of completion.

6. Monitoring
   Projects may be subject to an audit or any other form of monitoring by BCHEAN at any time.

7. Retention and storage of data
   The investigator is responsible for the storage and retention of original data pertaining to a project for a minimum period of five years.

Regards,

Dr Christopher Cheong
Chairperson
RMIT BCHEAN
Appendix E
Participant Information and Consent Forms

INVITATION TO PARTICIPATE IN A RESEARCH PROJECT

PARTICIPANT INFORMATION

Project Title: Investigating Income Tax Compliance Risks of Large Business in Indonesia

Investigators:

Mochammad Hadi Pratomo

Professor John Glover

Professor Steven Dellaportas

Dear .......................,

You are invited to participate in a research project being conducted by RMIT University. Please read this sheet carefully and be confident that you understand its contents before deciding whether to participate. If you have any questions about the project, please ask one of the investigators.

On behalf of Graduate School of Business and Law, RMIT University, we would like to invite you to participate in a research project on factors that influence corporate income tax compliance by the Indonesian large company. This research project is being conducted as part of the requirements for the doctoral degree (Law) studies carried out by Mochammad Hadi Pratomo whom research supervised by Professor John Glover (principal supervisor) and Professor Steven Dellaportas (co-supervisor). Professor John Glover and Professor Steven Dellaportas act as chief investigators for this research project and Mochammad Hadi Pratomo serve as an investigator. This project has been approved by the RMIT Human Research Ethics Committee.

You have been invited to participate because of your organisational knowledge and/or involvement in the area of Indonesian corporate income taxes.

This research seeks to explore and explain the factors that influence income tax compliance with the Indonesian large company in term of their income tax compliance behaviour from multiple perspectives and how tax administration responded to this behaviour. We aim to determine if the tax management system as part or corporate governance has some influence on large business tax compliance from both of practical and theoretical insights. We arrange to interview around seventy-five people for deeper understanding of corporate income tax compliance, tax management system and corporate governance.

If you agree to participate, we would request a semi-structured interview session, held face-to-face in your office or other agreed locations lasting approximately 45 minutes to 90 minutes. For the purposes of transcribing data, interview sessions will be audio recorded with your approval. Where appropriate, we would be pleased to review any archival evidence that you think would be a useful supplement to our interview data. While there is no direct benefit to participating, we anticipate that the findings of this research project might be helpful for future Indonesian tax regulations and its administration service enhancement as well as corporate governance development and its refinement capabilities.

Any information that you provide can only be disclosed if you supply the researchers with written permission.
The result of this research will be in thesis format available in RMIT Repository and publicly accessible online. Data collected will be transcribed and translated into English. All input to the research will be treated with the utmost care and confidentiality, and materials/data associated will be kept securely at RMIT for five years.

As a participant, you have the following rights:
- The right to withdraw from participation at any time;
- The right to request that any recording cease;
- The right to have any unprocessed data withdrawn and destroyed, provided it can be reliably identified and provided that so doing does not increase the risk for the participant;
- The right to have any questions answered at any time.

Yours sincerely

Mohammad Hadi Pratomo

Professor John Glover

Professor Steven Dellaportas
CONSENT FORM

1. I have had the project explained to me, and I have read the information sheet.

2. I agree to participate in the research project as described.

3. I agree:
   - to be interviewed, and
   - that my voice will be audio recorded.

4. I acknowledge that:
   (a) I understand that my participation is voluntary and that I am free to withdraw from the project at any time and to withdraw any unprocessed data previously supplied (unless follow-up is needed for safety).
   (b) The project is for the purpose of research. It may not be of direct benefit to me.
   (c) The privacy of the personal information I provide will be safeguarded and only disclosed where I have consented to the disclosure or as required by law.
   (d) The security of the research data will be protected during and after completion of the study. The data collected during the study may be published, and a report of the project outcomes will be available in thesis format. Any information which will identify me will not be used.

Participant’s Consent

Participant: ___________________________ Date: ________________

(Signature)

Participants should be given a photocopy of this PICF after it has been signed.
UNDANGAN UNTUK BERPARTISIPASI DALAM SEBUAH PROYEK PENELITIAN

INFORMASI PARTISIPAN

Nama Proyek: Mendalami Tax Compliance Risk Management Perusahaan Besar di Indonesia

Peneliti:
Mochammad Hadi Pratomo
Professor John Glover
Professor Steven Dellaportas

Yang terhormat ........................................,

Saudara diundang untuk turut berpartisipasi dalam sebuah proyek penelitian yang dilaksanakan oleh RMIT University. Silahkan membaca lembar ini dengan seksama dan pastikan Saudara memahami maksudnya sebelum memutuskan untuk berpartisipasi. Jika Saudara mempunyai pertanyaan tentang proyek ini, silakan tanyakan kepada salah satu peneliti.

Atas nama Graduate School of Business and Law, RMIT University, kami mengundang Saudara untuk turut berpartisipasi dalam sebuah proyek penelitian perihal Tax Compliance Risk Management pada perusahaan besar di Indonesia. Proyek penelitian ini dilaksanakan sebagai bagian dari persyaratan studi doktoral yang dikerjakan oleh Mochammad Hadi Pratomo dibawah bimbingan Professor John Glover (pembimbing utama) dan Professor Steven Dellaportas (pembimbing kedua). Professor John Glover dan Professor Steven Dellaportas bertindak sebagai pimpinan peneliti untuk proyek ini dibantu oleh Mochammad Hadi Pratomo sebagai peneliti lapangan. Sebagai informasi, proyek ini telah mendapat persetujuan dari komite etik RMIT.

Saudara di undang untuk berpartisipasi karena keterkaitan organisasi Saudara dan/atau keterlibatan Saudara pada bidang manajemen dan perpajakan di Indonesia.

Penelitian ini bermaksud untuk mengeksplorasi dan menjelaskan faktor-faktor yang mempengaruhi tax compliance di perusahaan besar Indonesia dan sudut pandang risk management. Kami ingin memahami sejauh mana sistem manajemen pajak perusahaan sebagai bagian internal dari corporate governance mempunyai pengaruh terhadap compliance baik dari sisi praktik maupun teoritis. Untuk itu kami akan melakukan wawancara terhadap kurang tujuh puluh lima partisipan untuk dapat mengetahui lebih dalam tentang corporate tax compliance, sistem manajemen risiko perpajakan dan corporate governance.
Jika Saudara bersedia berpartisipasi dalam proyek ini, kami ingin melakukan sesi wawancara semi-terstruktur yang berlokasi di kantor Saudara atau lokasi lain yang disetujui dan akan berlangsung antara 45 menit sampai dengan 90 menit. Harap dengar bahwa partisipasi Saudara adalah sepenuhnya bersifat sukarela dan Saudara dapat menarik diri dari tahapan wawancara kapanpun juga. Untuk tujuan transkripsi data, sesi wawancara akan direkam dengan persetujuan Saudara. Jika memungkinkan, kami juga akan melakukan review atas arsip atau dokumen yang Saudara yakini dapat berguna untuk melengkapi data wawancara. Walaupun tidak terdapat kontribusi langsung atas partisipasi Saudara, kami yakin hasil penelitian ini akan berguna untuk perbaikan peraturan dan layanan perpajakan dan juga bermanfaat bagi tata-kelola perusahaan (corporate governance) yang lebih baik.

Semua informasi yang Saudara sampaikan hanya akan kami ungkapkan jika Saudara memberikan izin tertulis kepada peneliti.

Hasil penelitian ini akan berbentuk disertasi yang disimpan di RMIT University dan dapat diakses secara online oleh publik setelah jangka waktu tertentu. Data yang dikumpulkan akan ditranskrip dan diterjemahkan ke dalam bahasa Inggris. Semua input akan dijaga kerahasiaannya dengan baik, dan data tersebut akan disimpan dan diamankan di RMIT University selama 5 tahun.

Sebagai partisipan Saudara memiliki hak-hak sebagai berikut:
• Hak untuk menarik diri dari partisipasi kapan saja;
• Hak untuk meminta penghentian perekaman;
• Hak meminta data yang belum diproses untuk ditirik kembali atau dimusnahkan, dengan catatan data tersebut dapat mudah diidentifikasi, dan dengan demikian tidak meningkatkan risiko kepada partisipan;
• Hak untuk memperoleh jawaban atas pertanyaan yang diajukan kapan saja.

Hormat kami,

Mochammad Hadi Pratomo

Professor John Glover

Professor Steven Dellaportas
FORMULIR PERSETUJUAN

1. Proyek ini telah dijelaskan kepada saya, dan saya telah membaca lembar informasinya.

2. Saya setuju untuk berpartisipasi dalam proyek penelitian sebagaimana dijelaskan.

3. Saya setuju untuk:
   - Diwawancarai; dan
   - Suara saya direkam

4. Saya menyatakan bahwa:
   
   (a) Partisipasi saya bersifat sukarela dan saya bebas menarik diri dari proyek ini kapan saja dan menarik kembali semua data yang belum diproses yang mana sebelumnya telah diserahkan (kecuali terdapat alasan keamanan).
   
   (b) Tujuan proyek adalah murni penelitian. Sangat mungkin saya tidak mendapatkan manfaat langsung dari proyek tersebut.
   
   (c) Keamanan dari informasi personal yang saya sampaikan akan dijaga dengan baik dan hanya akan diungkapkan atas persetujuan dari saya atau diminta oleh hukum yang berlaku.
   
   (d) Keamanan data penelitian akan dilindungi selama dan setelah penelitian selesai dilakukan. Data yang dikumpulkan selama penelitian dapat dipublikasi, dan hasil dari proyek ini akan tersedia dalam bentuk thesis. Semua informasi yang dapat digunakan untuk mengidentifikasi diri saya tidak akan digunakan.

Persetujuan partisipan

Partisipan: ___________________________ Tanggal: ________________

(Tanda tangan)

Partisipan wajib diberikan fotokopi lembar informasi dan formulir persetujuan ini setelah ditandatangani.
Appendix F
Permission Letter

KEMENTERIAN KEUANGAN REPUBLIK INDONESIA
DIREKTORAT JENDERAL PAJAK
DIREKTORAT PENYULUHAN, PELAYANAN, DAN HUBUNGAN MASYARAKAT

Number : S. 13/PJ.091/2015
Classification : Regular
Concerning : Permission to conduct research

January 13, 2015

Professor John Glover and Professor Steven Dellaportas
RMIT University
Melbourne VIC 3001
Australia

Dear Sir,

Referring your letter dated June 2nd 2014 concerning the request for permission to conduct research on behalf of:

Mochammad Hadi Pratomo, Mr.

herewith the Directorate of Dissemination, Service and Public Relations gives the permission for the student to conduct research in:

The Regional Tax Office of Large Taxpayers,
The Large Taxpayer Office One, and
The Large Taxpayer Office Two

as long as the information/data gathered during the research will only be used for academic purposes which is not for publication and the information/data gathered is not considered confidential as stated on article 34 Law Number 6 Year 1983 concerning General Provisions and Tax Procedures as lastly amended by Law Number 16 Year 2009.

This permission letter is valid for six (6) months since the issuance date and could be extended for three (3) months maximum by submitting a written request, which is submitted for no longer than 1 (one) week prior to the expiry date of this letter.

Having completed the research, the student must submit a copy of the results of the research in a hardcopy form to the Directorate General of Taxes Headquarters Library at Main Building, 3rd Floor, Jl. Jenderal Gatot Subroto Kav. 40-42, South Jakarta and in softcopy form

Thank you for your attention and cooperation.

On behalf of Director,
Head of SubDirectorate of Tax Dissemination,

Sanityais Juki Prawayani
NIP 196809151989032001

Kp.: PJ.091/PJ.0913
Appendix G
An excerpt of an interview transcript

File Name: Tax Official 16

Tanya: Bisa dimulai ya pak. Pada hari ini Selasa, 11 Agustus 2015, saya Mochammad Hadi Pratomo berkesempatan untuk mewawancarai Bapak XXX selaku XXX. Baik pak, untuk yang pertama pak yang ingin saya tanyakan. Kira-kira menurut penilaiannya, Bapak, perilaku kepatuhan wajib pajak yang ada di itu seperti apa ya pak?

Researcher ask: Can we start Sir? Today on Tuesday of 11 August 2015, I am Mochammad Hadi Pratomo has the opportunity to interview Mr. XXX as the Head of XXX. Well, First, I would like to ask you how about the compliance behaviour of taxpayers who are registered in this office?

INDEPENDENT TRANSLATOR: as the Head of Large Taxpayer Regional Office... what do you think of the compliance behaviour of taxpayers registered in your office?

Can we start Sir? Today on Tuesday of 11 August 2015, I am Mochammad Hadi Pratomo has the opportunity to interview Mr. XXX as the Head of XXX. Well, First, I would like to ask you, what do you think of the compliance behaviour of taxpayers registered in your office?


Answer: Well, about compliance, I think it should be grouped into two categories. The formal compliance and then the material compliance or the substantive compliance.

Talking about the formal compliance, here at LTO especially LTO 1, 2 and 3 because none of the individual taxpayer is registered here then (the formal compliance) is high. Almost all of taxpayers lodged their returns in time. However, in the case of individual taxpayer who registered in LTO 4 then their formal compliance was not as good as the companies’ compliance. But if you need the figures, I will show you okay? Secondly, about the substantive compliance, I think this is our challenge at DGT because there is no clear approach on how to measure this substantive compliance.

INDEPENDENT TRANSLATOR: AGREE

Well, about compliance, I think it should be grouped into two categories. The formal compliance and then the material compliance or the substantive compliance. The formal compliance in LTO especially LTO 1, 2, and 3, since there are no individual
taxpayers registered there, is high. Almost all effective taxpayers lodged their tax returns. However, individual taxpayers registered in LTO 4 have lower formal compliance compared to the companies’ compliance. I can give you the figures if you need. Secondly, regarding the substantive compliance, I think this is DGT’s challenge because there is no clear approach as to measure this substantive compliance.

Tanya: Jadi kepatuhan substansif ini apakah ini merupakan salah satu major issue gitu pak, isu yang besar yang ada di LTO ini pak?

Ask: So, about this substantive compliance…. Do you regard this as a major issue at LTO?

INDEPENDENT TRANSLATOR: So, regarding this substantive compliance, do you think that it is a major issue in LTO?


Answer: About substantive compliance. I said it is about a clear approach either at the DGT or LTO regional office. Well, this approach should be constructed from the audit results. And according to the audit review, there was no significant value of audit correction. If we based on this data then we may conclude that perhaps the formal compliance and the substantive compliance at LTO is relatively good, because there was no significant audit correction.

INDEPENDENT TRANSLATOR: Regarding substantive compliance, I mean a clear approach by DGT or LTO regional office, the approach should be constructed based on audit findings. According to the review of audit review, there is no significant value of audit correction. So, based on those data, we can conclude that material or substantive compliance in LTO is good because there is no significant audit correction.
### Appendix H

**Coding example**

<table>
<thead>
<tr>
<th>No.</th>
<th>Code</th>
<th>Participant’s Responses</th>
<th>Themes</th>
<th>Sub Themes</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>TO01</td>
<td>Regulasi adalah basis utama dalam setiap tindakan tax officer ya. Yang menjadi permasalahan di sini adalah banyak hal yang difatnya masih gray area, masih abu-abu</td>
<td>Regulation</td>
<td>Ambiguity</td>
</tr>
<tr>
<td>5</td>
<td>TO01</td>
<td>Knowledge yang paling utama jadi kendra. Kalau untuk knowledge di bidang lain tidak masalah, tapi knowledge mengenai international tax, dan TP</td>
<td>Institutional Capacity</td>
<td>Human resources issue</td>
</tr>
<tr>
<td>5</td>
<td>TO01</td>
<td>Semakin kompleks sebuah perusahaan, semakin banyak intercompany transaction, maka semakin besar risiko untuk avoidance atau bahkan evasion.</td>
<td>Corp Characteristics</td>
<td>Ownership structure &amp; business size</td>
</tr>
<tr>
<td>5</td>
<td>TO01</td>
<td>Saya hanya bisa membandingkan sebelum ada konsultan dengan sesudah. Kalau sesudah, pajaknya semakin turun sementara kondisi ekonomi ini increase, tapi tax nya malah decrease, dan itu terjadi seiring ad konsultan, saya pasti menduga itu adalah ulah konsultan, tapi tidak serta merta karena itu. Artinya itu adalah indikator, mungkin ini ada istilahnya avoidance action yang disaranakan oleh konsultan sehingga pajaknya turun. Itu pajak yang bisa kita deteksi seperti itu. Jadi kami selama ini tidak ada pernah memutuskan, ini karena konsultan. Kita tidak fokus ke konsultannya, tapi ke wajib pajaknya.</td>
<td>Corp Characteristics</td>
<td>Use of tax advisor</td>
</tr>
<tr>
<td>5</td>
<td>TO02</td>
<td>Ada beberapa sih wajib pajak yang dari sistem pengendalian internal mereka itu ada, ada saya ketemukan dalam datanya ada 1 barangkali yang wajib pajaknya gak, gak ini ya-- Sebenarnya menurut mereka patuh dari sisi akuntansi segala macam, tapi dari-- Karena kekurangan pengetahuan dari tim manajemennya mereka sehingga ada beberapa yang, yang dalam pengisian SPTnya kita, kita karena kita terkait dengan audit makanya ada beberapa yang tapi berbeda itu kalau dia perusahaan tunggal, tidak mempunyai afiliasi yang banyak, atau hanya punya satu atau dua afiliasi itu relatif gampang untuk bisa dikontrol oleh kantor pajak. Dan mereka tidak mempunyai transaksi yang difatnya distorted by related parties. Jadi dia adalah market, market transaction, market based transaction, transaction based on market itu. Bukan seperti transaksi afiliasi. Jadi struktur perusahaan itu semakin dia kompleks, kerenderungan</td>
<td>Corp Characteristics</td>
<td>TRM</td>
</tr>
<tr>
<td>5</td>
<td>TO03</td>
<td>Jika kita mau mengadministrasikan WP supaya memang dia sesuai dengan UU memang harus sistem yang terbuka. Sistem itu bukan, satu sistem yang terbuka kedua adalah penegakan hukum yang severe, yang serius. Itu dua poin. Kalau itu masih belum belum tegak, bener sistemnya belum reliable dan penegakan hukum juga belum tegak benar itu, memang jadi tingkat ketidakpatuhan, penyimpangan, irregulated lah ya irregulated itu memungkinkan, poin saya itu.</td>
<td>Institutional Capacity</td>
<td>Data management</td>
</tr>
</tbody>
</table>

| 256 |
# Appendix I

List of Interviews

<table>
<thead>
<tr>
<th>No.</th>
<th>Interviwee</th>
<th>Interview Date (dd/mm/yy)</th>
<th>Duration (in minutes)</th>
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</thead>
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</tr>
<tr>
<td>2</td>
<td>TO-02</td>
<td>11/08/15</td>
<td>24:31</td>
</tr>
<tr>
<td>3</td>
<td>TO-03</td>
<td>24/08/15</td>
<td>41:50</td>
</tr>
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