

THE DISTANCE BETWEEN US: A PRELIMINARY INQUIRY INTO TAXPAYERS' SOCIAL DISTANCE TOWARDS TAX OFFICERS IN INDONESIA

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ABSTRACT

The self-assessment system relies on taxpayers' voluntary compliance. The literature provides that the closer the distance between taxpayers and tax officers is, the more likely taxpayers to comply. This research looks at this phenomenon. For this purpose, a group small-business-owners were requested to complete a set of questionnaires constructed based on the Bogardus's social distance measure. One group of taxpayers named Friends of Tax/FOT (*UKM Sahabat Pajak/USP*) was particularly of interest due to their close association with the tax office. USP's social distance score is compared to that of other taxpayers and therefore, acts as a benchmark against which further comparisons are made. The results suggest that USP' members have a significantly closer social distance with tax officers compared to other taxpayers, which explains their close association with the tax office. Further comparison of social distance scores across groups of taxpayers are then made. An interesting finding that emerge is that those who identify themselves solely as small business owners have a significantly closer social distance compared to those who claim to be employed in private sectors. Other notable findings include the similar social distance score for taxpayers across education level and age while the extant literature supports the tendency for taxpayers to be less compliant as their education level is higher or as they are younger. This research to the best of the author's knowledge is the first attempt in Indonesia to measure social distance. It adds another layer of factors that can be used to improve taxpayer compliance.

KEYWORDS: tax, social distance, individual, voluntary compliance

1. BACKGROUND

Indonesia relies quite heavily on tax-based revenue sources as its revenue. In 2019 for instance, taxation¹ accounted for nearly 79% of all national revenue, which reached a sum of more than Rp 2,000 trillion across all types of revenue (BPK 2020). The share of tax on the overall national income slightly increased compared to that of the preceding year of 78%. The majority of this revenue was in the form of income tax, which contributed nearly 40% of total revenue, followed by Value Added Tax (VAT) at 27%. Again, these figures represented a slight increase compared to those of 2018 at 38.6% and 27.6% respectively. Income tax, hence, also contributed most of the tax-based revenue of around Rp 790 billion, which made it the largest revenue contributor in taxation, followed by, again, VAT at approximately Rp 535 billion thereby contributed 34% of revenue (Figure 1).

¹ This includes taxes administered by both the Indonesian tax office and the customs office.



Figure 1 The composition of tax-based revenue in 2019

Source: BPK (2020)

If we look closer on the overall income tax, then it can be seen that within the Indonesian income tax, more than one third of income tax revenue in 2019 was in the form of income tax paid by corporations. The next largest contributor of income-tax-based revenue in 2019 were income tax paid by employers on behalf of their employees and final tax at 18.8% and 16.5% respectively. These last two were levied based the withholding mechanism. Indeed, the taxes levied under this system contributed most at 57.6% compared to those paid by taxpayers purely based on the self-assessment system (Figure 2).



Figure 2 The composition of income tax revenue in 2019

Source: BPK (2020)

The lower right corner of Figure 2 interestingly also shows the minuscule share of income tax paid by individuals purely based on the self-assessment basis. The small box indeed represents 1.5% contribution of income tax paid by individuals on the self-assessment basis. This is the largest share of income taxes paid by individuals between 2004 and 2019. In fact, in this time period, the share of income taxes paid by individuals on a self-assessment basis is between 0.7%, which happened in the middle of the economic crisis in 2007, and 1.5% in 2015 and 2019

(Figure 3). On average, in this time period the average figure is 1% and seems to stabilise in this 15-year period.

On the other hand, Figure 3 also provides an evidence that income tax payments made by corporations consistently dominate income tax payments in Indonesia. Between 2004 to 2019, it can be seen in this figure that on average, corporations contribute nearly 38% of total income, which significantly dwarfs those made by individuals in the same period. In addition, income tax payments made by corporations, unlike those made by individuals, fluctuate more. Figure 3 thus shows that corporation tax payments are less stable than those made by individuals thereby indicating their high-risk nature as corporations, unlike individuals, are more prone to the fluctuations of the general economic condition.

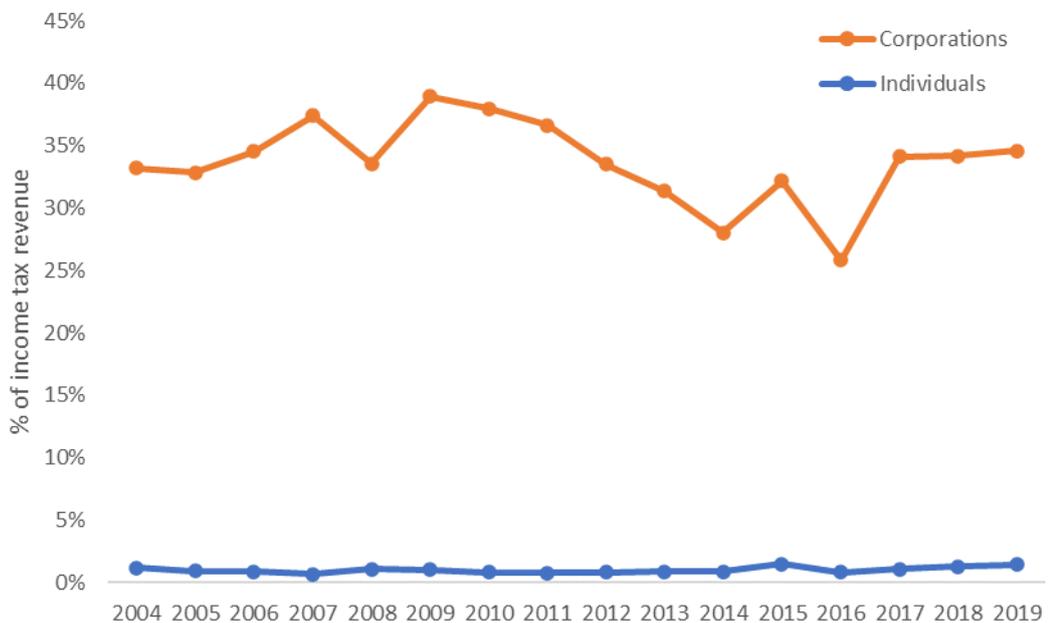


Figure 3 The share of individual and corporation income tax payments towards total tax income tax revenue in Indonesia (2004-2019)

Source: <https://www.bpk.go.id/lkpp>

As a comparison, the contribution of individual income tax to the overall tax revenue in OECD members on average 2000 and 2018 was between 22.9% to 24.0%, with an average of 23.5% (OECD 2020). The lowest contribution of individuals towards tax payments in this group of rich countries can be seen in Chile, where in the same time period has an average of only 6.9% of total tax revenue. On the other end of the scale, Denmark, quite expected, has the highest contributions of tax payments made by individuals of more than 53% of the total tax revenue in the same period. In contrast to what is evident in Indonesia, the income tax payments made by corporations in OECD member countries only reach less than 3% of total income tax revenue.

The lowest and highest figure are 2.6% and 3.6% respectively in 2009 and in both 2006 and 2007 before the sub-prime mortgage crisis in the US. This low figure, unsurprisingly, is perhaps related to the economic catastrophe sparked by the sub-prime mortgage crisis in 2008. Additionally, it can be seen in Figure 4 that tax payments made by corporations is significantly less than those made by individuals. Thus, it therefore provides an empirical support to the notion that developed

countries accumulate more income taxes from individuals than from corporations (Tanzi and Zee 2002). This figure also shows that the average tax payments made by both individuals and corporations in OECD member countries fluctuate significantly less than what is seen in Indonesia as shown in Figure 3. They also seem to collect more taxes from income than from consumption. Furthermore, they collect more taxes from income than from consumption.

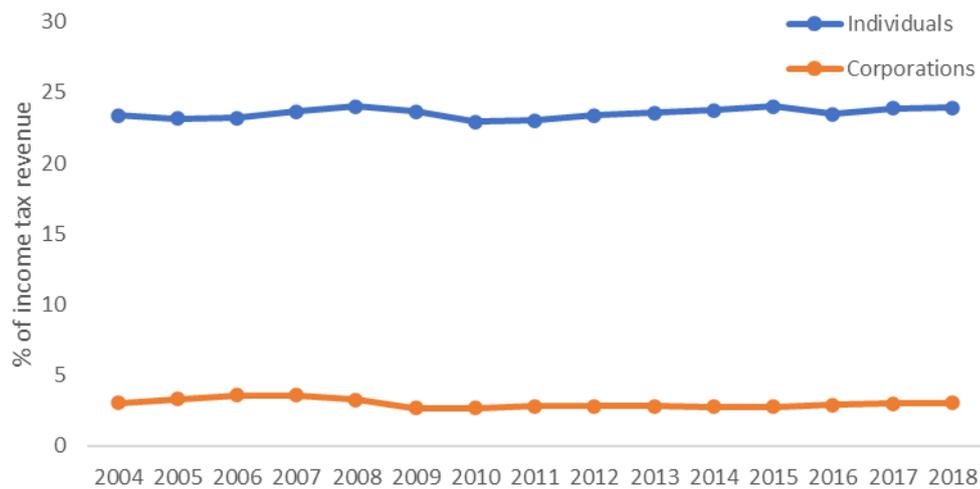


Figure 4 The OECD average of share of individual and corporation income tax payments towards total tax income tax revenue (2004-2019)

Source: <https://data.oecd.org/tax/>

While one might question the comparability in OECD member countries with Indonesia as tax revenue in OECD is generally higher than the rest of the world (Aizenman et al. 2019), it nevertheless can be used to provide a general description against which a certain degree of comparison can be made. It further provides a lesson for Indonesians that there still potential for revenue to be collected from individual income taxpayers. As tax payments in a self-assessment system is a function of taxpayer compliance, then it means there is an urgent need to improve the compliance of individual income taxpayers. The question would then on what factors that needs to be taken into account if one wishes to improve such compliance. This is the first base that motivates this research.

Another aspect worth looking is the income tax lodgement rate. Income tax return lodged by taxpayers undoubtedly is essential in ensuring taxpayer compliance. Information submitted through the tax return by taxpayer is taken to be truthful unless the tax office can prove otherwise. Tax return is thus seen as part of the signs of compliance as it symbolises taxpayers' willingness to trust the tax office with their income, which clearly is one of their inner-most private matters. Hence if one considers in looking into taxpayer compliance, then investigating the tax return lodgement rate is a good place to start. The Indonesian tax office classifies income tax return lodgement rate as an indicator of formal compliance.² As can be seen in Figure 5, the proportion of individual income taxpayers who lodged tax return between 2014 to 2018 continuously increased.

² Another indicator of compliance is material compliance, which generally refers to the accuracy of the tax return.

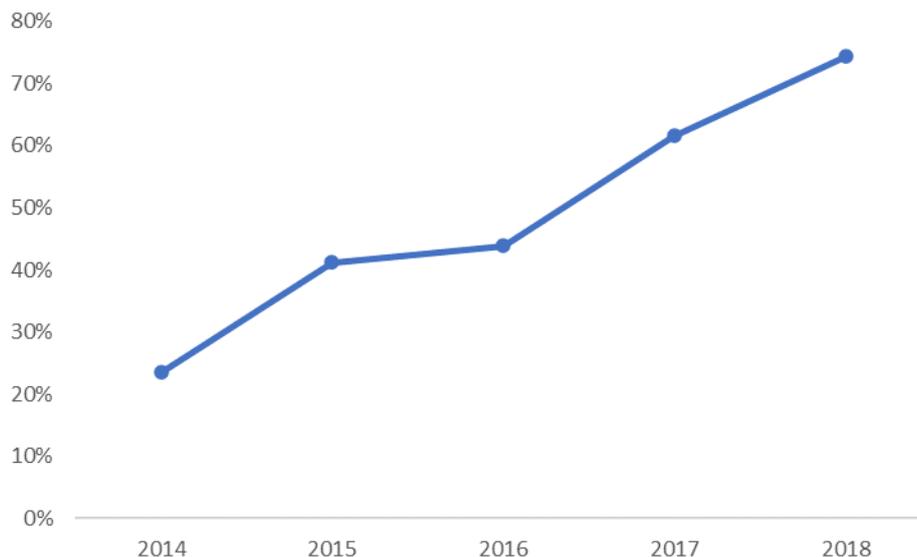


Figure 5 Individual income tax return lodgment ratio (2014-2018)

Source: Nur and Valentinus (2020)

While Figure 5 generally shows desirable outcome, its interpretation nonetheless cannot be separated from the small amount of their contribution towards the overall income tax revenue. As shown in Figure 3, it is reasonable to infer that there might indeed be a possibility that the tax returns lodged by individual taxpayers so far are perhaps not entirely truthful. To make matter worse, there is a high proportion of small business owners who are not registered as taxpayers and thus, do not make significantly contribution towards income tax revenue (Rosadi 2019). At the moment, it is believed that there are 1.69 million small business owners who are registered as taxpayers from approximately 59.2 million small business owners in Indonesia, which is less than 3%. To examine further, it can be seen in Figure 5 there was still approximately 26% of these taxpayers who did not lodge tax returns in 2018. It therefore is reasonable to argue that even if business owners are registered as taxpayers, it does not mean that the pay income taxes accordingly.

So, these facts illustrate that those who perhaps should register are not registered as taxpayers and those who are registered are arguably not fully pay their share of income tax. This sufficiently explains the phenomenon shown in Figure 3. In fact, there is a 58.87% reduction of newly registered taxpayers in 2019 who actually made income tax payments compared to the 2018 figure (DJP 2019: 72). It was reasoned that there was a difficulty in maintaining constant communication with taxpayers particularly in the year after there were registered. Some actually stopped making payments after only pay once when they were registered (DJP 2019: 73).

Several factors have been named to significantly affect taxpayer compliance in the in the contemporary literature, which will be discussed in detail in the literature review section, one of which is the social distance. It is outlined in the literature that the larger the perception of distance between taxpayers and tax officers, the more difficult it is for tax officers to make taxpayers comply with the rules. This research aims to shed light on the nature of social distance between these two groups of communities in Indonesia. Once this aim is achieved, the next step on making the distance closer can hopefully be mapped.

For this purpose, this paper is organised as follows. Firstly, the overall background is outlined, which is covered in this section. Secondly, a brief literature review outlining the contemporary picture of taxpayer compliance and how social distance come into play is presented. This is followed afterwards by the steps taken in this paper to address the aim of the research. A short presentation and discussion of the results are outlined in the section that follows. Lastly, this paper ends with a short summary that sums up the research and provides a description of weaknesses that readers need to be aware of.

2. LITERATURE REVIEW

As has been mentioned, taxpayer compliance is one of the essential ingredients in a tax system based on the self-assessment system. Taxpayer compliance has been studied extensively. The extant literature generally evolves around four streams (Schmutz 2016: 127). Firstly, theoretical models of (non) compliance are developed. These models are then empirically tested to identify the factors that significantly affect non-compliance. Laboratory experiments are also conducted at this stage to study individual taxpayer behaviour. The dynamics between various groups of actors in the compliance games are then simulated. These steps have resulted in a number factors as illustrated in Figure 6.

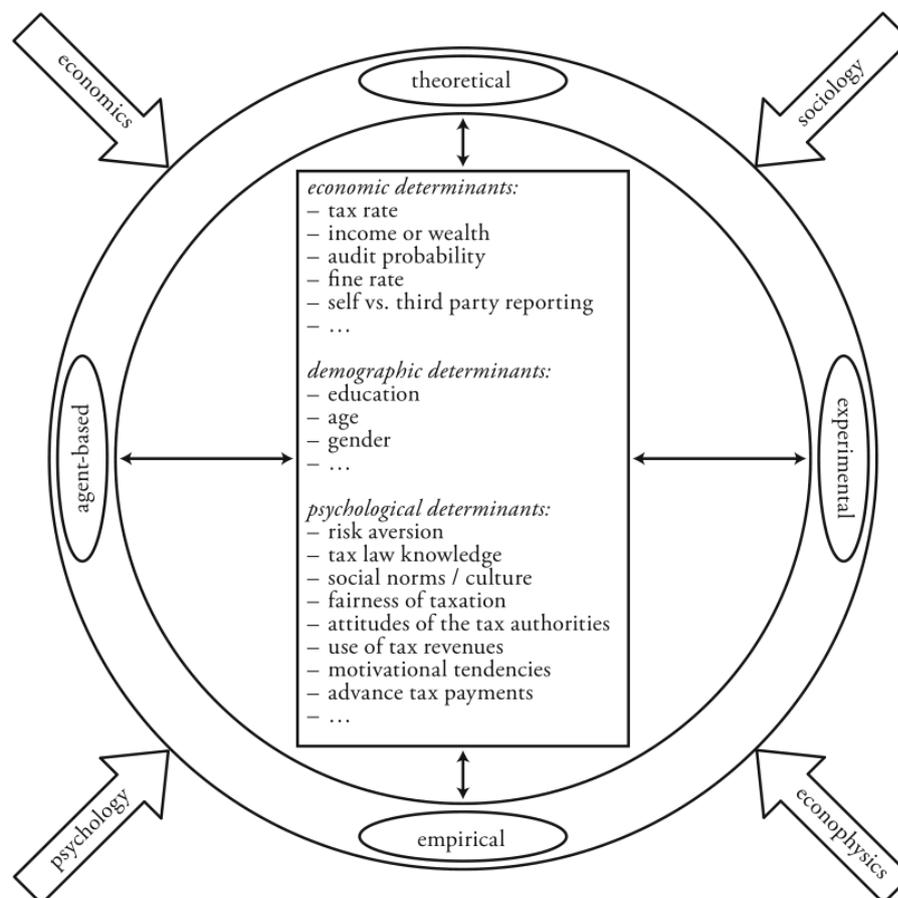


Figure 6 Factors influencing taxpayer compliance
Source: Schmutz (2016: 128)

Researches in taxpayer compliance started with the work based on econometrical model developed by Allingham and Sandmo (1972), which is based on (Becker 1968). The main assumption in their model is that taxpayers behave rationally, in a sense that they strive to maximise their utility. Hence, taxpayers will minimise tax payments as much as possible. They conclude that penalty and probability of detection generally can be used to significantly improve compliance. Taxpayers' income tax rates, however, do not have a clear-cut effect on compliance.

While generally this model is considered logical, later works however provide that this economical approach are not supported by strong empirical findings (Kirchler et al. 2010). Further, there is also evidence that taxpayer compliance is often higher than one predicted by the econometrical model (Alm, McClelland and Schulze 1992; Feld and Frey 2002: 88). Psychological determinants are thus offered – such as norms, culture, or trust to the tax authority – to complete the picture (Figure 6). Tax morale, fairness, and complexity are also considered to be important in shaping taxpayer compliance (Taing and Chang 2020). Additionally, in an Indonesian context at least, referral groups are found to be significantly affect taxpayer compliance (Inasius 2019).

One key factor not widely discussed in the literature is social distance. Social distance can be regarded as messages or signals sent by some people to other parties – tax authorities included – on how those people place themselves from those parties in such a way that they are outside other parties' reach, do not hear or follow their demands, and are willing to fully accept the consequences of this action (Braithwaite, Murphy and Reinhart 2007). It is driven by a comparison of one's position from another (Ein-Gar and Levontin 2013: 199).

It is believed that social distance can significantly affect taxpayer compliance. Fullarton (2013) for instance, considers social distance as one of the factors that generally provides a background in shaping the miners' decision in Pilbara, Western Australia to participate in the mass-marketed tax avoidance scheme in the 1990s. The greater the perceived distance is, the lower the compliance would be (Fullarton 2013: 103). This makes it more difficult for the authority to actually persuade people to comply with the rules (Bartel and Barclay 2011: 155). Fullarton further describes that the relationship between tax compliance and social distance can be best illustrated in Figure 7.

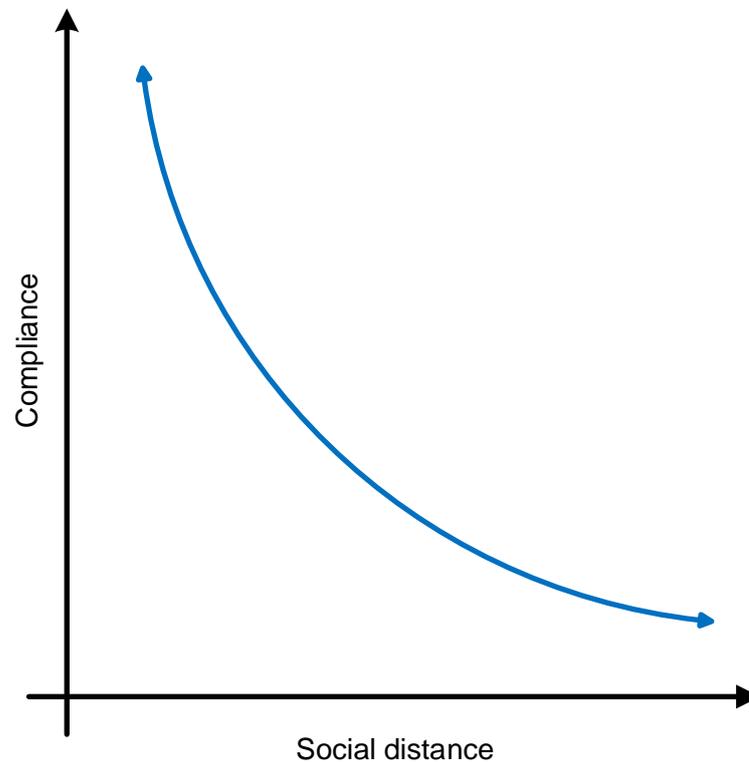


Figure 7 Social distance and taxpayer compliance
Source: Fullarton (2013: 104)

One way to see the importance of social distance towards taxpayer compliance is through the so-called motivational posture. Coined by Braithwaite (2003: 17), motivational posture generally examines how a person perceives their relationship with the authority, ranging from fully cooperative (commitment) to disengagement (Braithwaite 2003: 20). In this farthest distance, taxpayers put themselves outside the system (Hartner et al. 2008). As individuals continuously evaluate the authority's performance, they regularly examine their position towards the authority. This evaluation eventually builds up overtime. Central to this concept of positioning is the social distance firstly advocated by Bogardus (1925). How a person associates themselves with the authority generally dictates the distance that person wants to place between themselves and the authority (Braithwaite 2003: 18). In a rather different context, it was shown that those with a less social distance with a target donation tend to be willing to donate more compared to those with wider distance (Ein-Gar and Levontin 2013: 200). It is therefore – based on these literatures – reasonable to believe that taxpayers with less social distance with tax officers will tend to be more willing to pay taxes than those with more social distance.

This research seeks to answer two questions:

1. Is the social distance between individual taxpayers and tax officers is large that it prevents voluntary compliance to sufficiently materialise?
2. How social distance change across several demographical factors such as age, education, occupation, and gender?

To answer the first question, it is firstly hypothesised in this research that the social distance between taxpayers who belong to FOT is significantly lower than

those outside FOT community. And then in an attempt to answer the second question, this research compares changes in social distance across various the aforementioned demographical factors. These factors are chosen as literature has shown that taxpayer compliance varies as these factors change. This will be discussed in detail in the following section.

3. METHOD AND DATA DESCRIPTION

To address the research concern outlined in the preceding section, this research uses a set of questionnaires. The questionnaires were constructed based on the social distance theory, which was made famous by Bogardus (1925). His work resulted in a scale which was regarded as the most reliable scale in measuring social distance (Nix 1993). The questionnaires were administered to two group of taxpayers. The first group was an informal organisation consisting of small business owners in South Tangerang.³ This group of taxpayers – commonly known as Friends of Tax/FOT (*UKM Sahabat Pajak/USP*) – are locally known for their close relationship with the tax office (Prasetyo and Djufri 2019). Starting as a group of small business owners who participated in a series of entrepreneurial workshop sponsored by the tax office, members of this group today frequently organise meetings, discussions, and workshops discussing tax matters relating to small business owners. Their senior participants are often requested to deliver tax education and talks in Banten and Jakarta. Due to the nature of their relationship with the tax office, this research uses the members of this group to establish a benchmark of social distance.

The questionnaires were also administered to another group of taxpayers. These taxpayers were small business owners who participated in a series of tax workshop for small business owners organised by the tax office and PKN STAN.⁴ These workshops ran three times in August 2020, but the questionnaires were only administered to participants of workshop conducted on the 24th and 31st August 2020. In total, there were approximately 300 participants attended these workshops.⁵

These two group of taxpayers were requested to complete an online questionnaire saved in a Google Form format.⁶ The questionnaire consisted of only seven question aimed to capture the social distance between the respondent and tax officers where the respondents were requested to respond to the questions using a 4-point Likert scale. This departs from the original Borgardus's scale where respondents are normally not requested to complete a Likert scale and rely instead on the fixed score for each question. Although this approach – as noted previously – has been regarded reliable, some drawbacks are nevertheless evident (Mather, Jones and Moats 2017; Clogg and Sawyer 1981). For this reason, this research modified the original Borgardus's scale and requested the respondents to complete the Likert scale for each question. A final score – named iScore – was then calculated based on the respondents' complete responds using the procedure outlined by Mather, Jones and Moats (2017). The means of iScore across group of respondents were then compared to obtain an overview of the social distance between

³ This area is officially under the administration of the Pondok Aren district tax office.

⁴ PKN STAN is a vocational college under the administration of the Ministry of Finance.

⁵ This number is the approximation provided by the organiser of the event. The exact number of those attending the events was unfortunately not made available to the researcher.

⁶ The questionnaire can be accessed online at https://bit.ly/Anda_dan_Petugas_Pajak.

these group of taxpayers and tax officers. As has been mentioned, the online questionnaires were distributed to the members of FOT and participants of taxpayer education workshops for small business owners. Social distance score reported by the FOT members will be used as a benchmark as they generally are known for their close relation with the tax office.

Out of approximately 300 respondents, 143 completed the questionnaires in full, resulting in an approximately 47.67% of response rate. Nearly 31% of these respondents claimed to be affiliated with FOT where most – 74.13% – belonged to the productive age group of between 29 and 50 years of age. They were also generally well-educated as more than 81% finished a graduate-level of education or higher. Interestingly, female seems to dominate the overall respondent proportion (63.64%) as opposed to male with only 36.36% of proportion. As for occupation, it seemed that most respondents had a job in addition to having a business either as a civil servant or work in private companies. Only less than 21% of respondents solely worked as small business owners.

FOT members mostly represented a similar situation. Out of 44 members who responded to the survey, more than 80% were female, predominantly (56.81%) aged between 29 and 50 years old. In addition, FOT members were generally well-educated as more than 60% of them have at least a bachelor-level education. However, unlike those who were not part of the FOT community described in the preceding paragraph, respondents who identified themselves as FOT members were predominantly (61.36%) listed small business owner as their sole occupation. It is against this background that the social distance measurement was undertaken. The following section outlines the results in in detail.

4. RESULTS AND DISCUSSION

This section outlines a set of results obtained from analysing the respondents' response which will be followed by a general discussion. The analysis are carried out using Minitab version 19 using parametric statistical techniques as they offer more opportunities, are relatively robust to violation of normality and moreover, can be relatively accurate to be applied on Likert-based data (Norman 2010). Comparable non-parametric tests are be performed from time to time for comparison purposes. Further, the interpretation of the results and discussions will be carried out using the respondents' attributes as background information.

The presentation of the results firstly starts with an overall description of the social distance score. As has been stated, the were 143 respondents who responded to the online survey. The mean of the social distance score is 47.20 (SD=17.48) with a minimum and maximum score of 28 and 102 each. Further, the median of the social distance score does not seem to depart significantly from the mean ($Q_2=44$, IQR=24) although the Kolmogorov-Smirnov test shows that the social distance score seems to violate the normality assumption ($p<0.01$). FOT members indeed have a significantly lower mean of social distance score compared to non-FOT members. FOT members in this case have a mean social distance score of 41.93 (SD=12.46) which is lower to that of non-FOT with a 49.55 (SD=18.89) mean score. At a 95% confidence level, the t test shows that this score difference is indeed statistically significant ($p=0.003$). Similarly, the Mann-Whitney test also supports this result ($p=0.025$). Thus, judging from these results, it can be concluded that FOT members do indeed have a closer relationship with tax officers. This provides the answer to the first research question.

The second part of this section deals with the comparison of social distance score across several groups of the respondents. The first comparison is between male and female respondents. The analysis shows that the means of the social distance score for male and female respectively are 47.52 (SD=19.79) and 47.02 (SD=16.13) which is not significantly different ($p=0.439$). The Mann-Whitney test also produces a similar conclusion ($p=0.710$). Hence, we can see from these results that there seems to be no significant difference in the respondents' view regarding their position towards tax officers in term of their gender.

The comparisons of means of social distance score next is performed for education level of the respondents. This comparison is of particular interest especially because laboratory experiments provided an indication that taxpayers with higher education tend to be less compliant (Juanda 2010; Prasetyo and Sinaga 2017). As social distance has been recognised as a concept to explain how individuals place themselves from the authority (Braithwaite, Murphy and Reinhart 2007) and therefore it is a mean to evaluate the effectiveness of the authority's efforts to persuade those individuals in complying certain regulations (Bartel and Barclay 2011), it is thus closely linked with the concept of compliance. Responses from the respondents show that the means of social distance score do not significantly different across taxpayers' education level ($p=0.189$). The results obtained from the Kruskal-Wallis test also confirm this ($p=0.227$).

These results somehow complement the results from laboratory experiments mentioned previously. While these experiments provide evidence of negative correlation between education level and compliance level, this research offers a different picture where respondents across different level of education seem place themselves in a not so different manner from tax officers. This research thus suggests that approaches taken by tax officers to persuade the respondents to comply with tax rules will most likely be treated in a similar fashion regardless of their education level.

Another worth noting results is evident in the comparisons of means of social distance score across occupations. The ANOVA shows that certain group of occupations do indeed have significant differences in their means of social distance score ($p=0.017$) although the Kruskal-Wallis test fail to corroborate this ($p=0.057$). a further examination using Tukey's pairwise comparisons procedure provides that respondents who also work in private companies tend to have a significantly larger mean of social distance score (55.56) compared to that of respondents who solely work as small business owner (42.10). This also evident when compared to respondents who did not specifically claim to have an addition occupation (43.42).

These results raise a question whether the significantly higher mean of social distance score is a result of their lack social interaction with the tax office. It is quite possible that those who solely rely on running a small business as their sole occupation might have more intensity in interacting with the tax office as demanded by their occupation. Whereas those who work in private companies – and perhaps treat their business simply as a way to make more money in addition to their regular salary and wages – may not have similar intensity in interacting with the tax office as most of their tax matters are quite possibly dealt by their employers through the withholding mechanism (article 21 of the income tax act). This result is of interest as it contradicts with the literature where it is generally believed that those who are self-employed tend to be less compliant (Alm 2019; Prasetyo 2011) if the assumption that social distance and taxpayer compliance are negatively correlated is to be accepted. Nevertheless, it has been suggested that as self-employed taxpayers

become older, they tend to be more compliant probably because of differences in their mental accounting (Alm, Kirchler and Muehlbacher 2012). In this research, most of the respondents indeed belong to the more senior cohort as nearly 40% of the respondents are between 40 to 50 years of age. This perhaps explains the reason behind this phenomenon.

The last part of the analysis deal with the comparison of means across age groups. The ANOVA procedure indicates that there are no significant differences in means of social distance scores across age groups of the respondents ($p=0.689$), which is also corroborated by the Kruskal-Wallis test ($p=0.897$). Again, if the assumption of negative correlation between social score and taxpayer compliance is to be accepted, these results seem to contradict with the literature where young taxpayers are considered to be generally less compliant (Alm 2019). Nonetheless, the fact that younger taxpayers are not significantly different than their more senior counterparts can generally be regarded as beneficial due to their productivity. This last part of data analysis concludes this section.

5. CONCLUSION

One of the important factors influencing taxpayer compliance identified in the literature is social distance. This concept generally explains how taxpayer position themselves from the authority. It is generally established that the larger the social distance is, the more difficult it is for tax administration to persuade taxpayer to comply. In this sense, therefore, social distance is related to taxpayer compliance. This research seeks to shed light on this topic. For this purpose, an online questionnaire based on Bogardus's work was distributed to two distinct group of taxpayers. The first group was the FOT, which was recognised with their close cooperation with the tax office. Their social distance score is thus used as a benchmark.

In a nutshell, it can be concluded that FOT members generally have a significantly lower social distance score compared to that of non FOT respondents, which explains their close relationship with the tax office. A second set of comparisons are also conducted to explore differences of social distance scores across groups. The results show that there are no significant differences in social distance scores across age, sex, and respondents' education level. If it is accepted that social distance is negatively correlated with compliance, these results somehow are different from evidence found in the literature where young taxpayers and taxpayers with higher education level are generally regarded as less compliant. Further, this research also reveals that small business owners generally have a closer social distance towards tax officers compared to respondents employed by private companies. This also somewhat different from the literature were self-employed taxpayers are seen to be less compliant. Again, this interpretation is under the assumption of the negative correlation between social distance and taxpayer compliance.

6. POLICY IMPLICATION AND RESEARCH LIMITATION

This research sheds light on the nature of taxpayers' social distance. The literature recognises that a large social distance only makes efforts to persuade taxpayers to comply more difficult. A direct policy implication is that tax office needs to make more efforts to close the gaps between taxpayers and tax officers. In this regards, more social interactions are certainly preferred. Events aimed at aiding taxpayers are essential. The focus is on closing the gap and expanding business network as opposed to a one-way information dissemination with a sole intent of making taxpayers comply. Events such as business networking, marketing, trade

exhibition, or entrepreneurial workshops are thus more desirable than a seminar or a tax education event that normally is geared towards introducing a new set of tax rules. The tax office currently has the business development service program which – if ideally executed – can serve this purpose.

This research however was conducted under one main weakness. Data collection was carried out in a situation that covered taxpayers who were present at tax education workshops. Questions therefore can be raised regarding the views of those who did not attend these workshops as their voice was clearly under-represented. This certainly makes the generalisation problematic as not all taxpayers have the same probability to be included in the survey. This research is, in a way, an early attempt to measure social distance between taxpayers and tax officers. As such, the results reported in this paper must be carefully read and interpreted in light of these limitations.

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