



# Reciprocal Relationship between Taxpayer's Compliance and Governance Quality

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## ABSTRACT

This study aims to test the existence of a reciprocal relationship between taxpayer compliance and governance quality. From the first model with governance quality as a mediating variable, it is proven that it can mediate the level of taxpayer knowledge so that it will be able to strengthen the level of taxpayer compliance further through governance quality. However, governance quality cannot be a mediating variable for tax morale. From the second model, with taxpayer compliance as the mediating variable, it is proven that it can mediate the level of taxpayer morale so that the role of taxpayer compliance further strengthens the level of governance quality. However, for tax knowledge, the role of tax compliance cannot be a mediating variable.

**Keywords:** Tax Morale, Tax Knowledge, Governance Quality, and Tax Compliance

**JEL Classifications:** H31, M410

## 1. INTRODUCTION

The degree of adherence to tax regulations reflects the vitality of a society's functioning. Consequently, numerous research endeavors have delved into enhancing tax compliance, a focal point within economic literature. Diverse investigations scrutinize the determinants influencing tax compliance levels (Bhargava and Manoli, 2015; Hoopes et al., 2015; Benzarti, 2017). Of particular interest to policymakers in fostering economic growth and transition is the promotion of robust tax compliance. Tax compliance encompasses the accurate declaration of taxable income and the punctual settlement of tax obligations. Given the intricacies of tax compliance, addressing behavioral complexities necessitates a multifaceted approach, utilizing varied methodologies and data sources. This is crucial as tax evasion constitutes an illicit activity, with each approach possessing its own set of strengths and weaknesses, demanding comprehensive data for thorough analysis.

The willingness to fulfill tax obligations stems from either the sense of duty or the belief in societal contribution through taxation,

manifesting in tax morale and tax knowledge. Tax morale refers to the inherent drive to fulfill tax obligations driven by a moral sense or the conviction to contribute to the nation through taxes (Torgler, 2003). Similarly, Tax Knowledge plays a pivotal role in voluntary tax compliance systems and significantly influences taxpayer behavior within the self-assessment framework (Kasippilai, 2000; Loo et al., 2008; 2009), particularly in determining accurate tax liabilities (Palil, 2005; Saad et al., 2003). Effective governance is indispensable across all sectors, fostering the proper implementation of agreed-upon rules and policies. The promotion of Good Governance is instrumental in emphasizing the principles of Accountability and Transparency, thereby bolstering tax compliance amidst political stability and the enforcement of relevant tax regulations.

The relationship between governance quality and tax compliance is reciprocal, meaning both variables influence each other. This implies that one variable can act as a cause and also as an effect for the other variable, and vice versa. Damayanti and Supramono (2019) demonstrate that the perception of tax authorities' authority

and the interplay between these variables impact tax compliance. Remarkably, taxpayers demonstrate the highest compliance when there is a sense of trusted reciprocity. In such instances, the perception of tax authorities' authority becomes less significant in explaining tax compliance. Hence, mutual trust is paramount. Tax authorities must consistently cultivate a sense of trust in taxpayers, and vice versa, as it is pivotal for the government's success in enhancing tax compliance.

In Indonesia, taxpayers encompass both individual and corporate entities. Among individual taxpayers are professionals, a group integral to contemporary business operations. Professionals earn income through their specialized skills, which inevitably entail tax obligations. These professionals engage in independent work and include doctors, consultants, notaries, accountants, lawyers, architects, actuaries, and appraisal services. According to DJP Regulation Number PER-16/PJ/2016, professionals are classified as income earners from service work rather than as employees.

According to a report by the Director General of Taxes in Indonesia, the compliance rate among non-employee individual taxpayers has declined compared to their employee counterparts. This research investigates the compliance level of individual taxpayers, focusing on professionals who possess advanced education levels. The study explores the intrinsic motivation (tax morale) and extrinsic factors (tax knowledge) influencing taxpayer compliance among these professionals. Additionally, it examines the reciprocal relationship between tax compliance and governance quality as a mediating variable in shaping the compliance level of these professionals.

## 2. LITERATURE REVIEW

This study employs attribution theory, a theoretical framework elucidating how individuals perceive and interpret their and others' behaviours based on internal and external influences. It suggests that people attribute actions to internal factors stemming from personal psychological states and external factors originating from environmental conditions (Pasaribu and Wijaya, 2017).

This research also utilizes the Theory of Planned Behavior (TPB) to explore the correlation between tax morale, governance quality, and taxpayer compliance. According to TPB, attitudes, subjective norms, and perceived behavioural control shape intentions, subsequently influencing taxpayer actions. However, in the context of this study's TPB framework, political stability and the rule of law are influenced by attitudes and subjective norms. Taxpayer behaviour towards the government's services and goods exchanged for taxes paid is moulded by their attitudes and subjective norms. Favourable attitudes towards governmental performance foster perceptions of enhanced political stability and the efficient rule of law, thereby encouraging support for higher tax morale and implying better tax compliance. This aligns with the assertion by Bobek and Hatfield (2003) that willingness to comply with taxes is directly linked to one's attitude toward tax payment. Subjective norms refer to individuals' inclination to emulate others. Taxpayers residing in politically stable environments with robust rule of law serve as models for others, bolstering better tax compliance. Bobek

et al. (2013) discovered that ethical attitudes and beliefs influence taxpayer morale. A taxpayer's dedication to compliance contradicts their values or principles, impacting their moral judgment. Thus, the notion that taxpayers with positive attitudes tend to exhibit higher tax morale is substantiated, positively influencing their compliance behaviour.

### 2.1. Tax Morale

Tax morale can be defined as an inherent motivation to fulfill tax obligations stemming from a sense of moral duty or a belief in contributing to the state through taxation (Torgler, 2003). It gauges individual attitudes rather than behaviors and reflects a moral obligation or societal contribution through tax payment. Indicators of tax morale encompass citizen participation levels, trust levels, autonomy or decentralization degrees, demographic factors, economic conditions, national pride, deterrents, and the tax system. Various studies have explored the impact of individual-specific factors on tax morale. Notably, socio-demographic and socioeconomic backgrounds influence tax morale, correlating with tax evasion and corruption. Public expenditure can mitigate financial losses resulting from tax evasion. Sanyal et al. (2000) discovered that tax revenues might decrease with income tax rates in the presence of corrupt tax officials. Moreover, Joulfaian's (2009) empirical findings indicate increased business non-compliance amidst corruption, suggesting that tax evasion flourishes where bribing tax officials is common practice. Corrupt tax officials might incentivize tax evasion by soliciting bribes from taxpayers. Previous studies exploring the link between corrupt tax officials and tax evasion have established a positive association between them (Crequeti and Coppier, 2009; Gupta, 2008; Imam and Jacobs, 2007).

### 2.2. Tax Knowledge

Tax knowledge plays a crucial role in the voluntary tax compliance system and stands out as the primary determinant of taxpayer compliance behavior, particularly within the self-assessment framework (Kasippilai, 2000; Loo et al., 2008; 2009). This significance extends to the accurate determination of tax liabilities (Palil, 2005; Saad et al., 2003). Amalia and Hapsari (2018) define taxation knowledge as taxpayers' proficiency in understanding taxation rules, including tax rates mandated by the law and the benefits of taxes relevant to their lives. Simplified, tax knowledge refers to taxpayers' capacity to comprehend tax laws and regulations (Ayuba et al., 2016). Pratama (2018) further elaborates that taxation knowledge encompasses fundamental tax concepts, incorporating tax regulations and financial understanding necessary for fulfilling tax obligations. Gore and Wong (1998) categorize taxation knowledge into procedural knowledge (knowing how) and declarative knowledge (knowing that).

### 2.3. Tax Compliance

Tax compliance serves as an indicator of societal well-being. Tax compliance denotes taxpayers' willingness to fulfil their tax duties by legal regulations without requiring audits, extensive investigations, warnings, or imposing penalties and legal or administrative measures (Gunadi, 2013). Kurnia (2013) distinguishes tax compliance into formal and material categories. Formal compliance occurs when taxpayers meet their tax

obligations according to the formalities outlined in the law. At the same time, material compliance involves fulfilling formal obligations and ensuring the material completeness of their tax-related aspects. Encouraging a high level of tax compliance is a significant concern for policymakers in economic development and transitional periods. Tax compliance entails accurate reporting of taxable income and timely tax contributions. Given its complex behavioural nature, tax compliance necessitates various methods and data sources for investigation due to the illegality of tax evasion. Each method possesses strengths and weaknesses, and field data often requires supplementation for thorough analysis.

#### 2.4. Governance Quality

The quality of governance holds significance for citizens due to its advantages. Rodriguez-Justicia and Theilen (2018) discovered that countries characterized by poor governance and minimal checks on corruption tend to exhibit low tax morale among individuals with lower levels of education. Furthermore, the perceived low quality of government-provided goods and services negatively impacts people's tax morale and compliance (Everest-Phillip and Sandall, 2009). However, taxpayers are more inclined to fulfil their tax obligations if they perceive the government as transparent and accountable in its utilization of public funds (Meagher, 2018). Taxpayers' perception of good government quality encompasses political stability and adherence to the rule of law. Positive tax compliance is evident when the government demonstrates effectiveness, such as proficient external debt management and an efficient financial system (Nkundabanyanga et al., 2017).

#### 2.5. Research Framework

As per the Indonesia Governance Index 2012, governance entails the formulation and execution of rules, regulations, and development priorities through interactions among executives, legislators, bureaucracy, civil society, and the economic community (Kemitraan, 2013). Government Regulation No. 101 of 2000 defines good governance as applying principles like professionalism, accountability, transparency, excellent service, democracy, efficiency, effectiveness, and adherence to the rule of law, which are acceptable to the entire community (Rahman, 2009). Rahman's (2009) research, employing indicators of good governance, suggests a significantly positive impact of good governance on taxpayer compliance. Additionally, Alijoyo and Subartono (2014) elucidate governance in terms of governance structure and governance process or mechanism within a company. Governance structure refers to the arrangement of responsibilities and division of roles among critical organs of the company, namely shareholders, commissioners, and managers. On the other hand, the governance process denotes the operational mechanism and interaction among these organs.

The quality of governance, gauged through factors like political stability and adherence to the rule of law, has the potential to establish a conducive atmosphere wherein taxpayers can fulfil their tax responsibilities effectively. This environment may mediate intrinsic factors such as tax morale and extrinsic factors like tax knowledge, ultimately leading to enhanced taxpayer compliance. Subsequently, the formulated hypothesis and research framework are outlined as follow:

H<sub>1</sub>: Good Governance Quality can mediate the positive effect of tax morale and tax knowledge on Tax Compliance (Figure 1).

A mutual relationship exists between governance quality and tax compliance, known as a reciprocal relationship. This indicates that both variables can act as causes and effects for each other, creating a scenario where it is challenging to determine which variable is the cause and which is the effect. For instance, high levels of taxpayer compliance can contribute to economic growth in a country, subsequently improving the quality of government. Hence, this study aims to examine tax compliance as a mediating variable between intrinsic factors such as tax morale and extrinsic factors like tax knowledge, aiming to enhance the quality of government. As a result, the formulated hypothesis and research framework (Figure 2) are presented as follows:

H<sub>2</sub>: Tax Compliance Can Improve Governance Quality

H<sub>3</sub>: High tax compliance can mediate the positive effect of tax morale and tax knowledge on governance quality.

### 3. RESEARCH METHODOLOGY

This quantitative research employs primary data from a questionnaire survey targeting expert individual taxpayers. The questionnaire was developed based on established tax literature in Indonesia and comprises five sections. The first section delves into the respondents' background, including their occupation type, location, gender, age, and education. The second section consists of five questions about taxpayer compliance, with the likelihood of taxpayers voluntarily fulfilling tax obligations serving as the dependent variable, as adopted by Kirchler and Wahl (2010). The third section comprises six questions concerning tax morale, characterized as an intrinsic motivation to pay taxes, drawing from studies by Luttmer and Singhal (2014) and Torgler et al. (2007). The fourth section features four questions related to tax knowledge, with the likelihood of taxpayers voluntarily complying with tax payments serving as the dependent variable, also adopted from Kirchler and Wahl (2010). Finally, the fifth section explores governance quality,

Figure 1: Research framework model 1

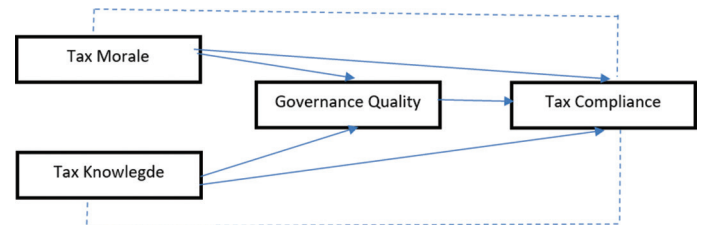
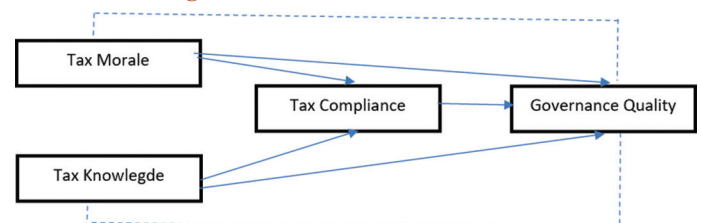


Figure 2: Research framework model 2



focusing on two governance variables, political stability and the rule of law, based on Torgler's (2011) argument. This section, encompassing three items on political stability and four on the rule of law, aims to gauge respondents' perceptions of governance.

This study focuses on expert individual taxpayers, defined as independent professionals engaged in various service-based occupations such as doctors, consultants, notaries, accountants, lawyers, architects, actuaries, and appraisal services. According to DJP Regulation Number PER-16/PJ/2016, these experts are classified as income recipients associated with service work, rather than as employees. The sample characteristics include certified experts who are also taxable entrepreneurs with an annual turnover exceeding 500 million. A Likert scale with intervals ranging from 1 to 4 is employed in this study. Dianti and Dewantara (2021) advocate for a modification of the Likert scale to address its inherent weaknesses. The modified Likert scale eliminates the middle answer category due to several reasons: (1) the middle category often carries multiple interpretations, such as neutrality, agreement, disagreement, or uncertainty; (2) inclusion of the middle answer tends to skew responses towards the middle; (3) the primary aim is to gauge respondents' inclination towards agreement or disagreement. In the 1-4 Likert interval, a weight of four indicates strong agreement (SS), three signifies agreement (S), two denotes disagreement (TS), and one represents strong disagreement (STS).

Data processing employs Smart PLS 4.0 with Structural Equation Modeling (SEM). The validity test aims to determine if a questionnaire is valid, indicating whether the questions on the questionnaire effectively measure the intended constructs. This is assessed by examining each indicator's loading factor values, requiring the value to exceed 0.70 to establish validity. Discriminant validity ensures that indicators of different constructs are not overly correlated. In SmartPLS 4.0, discriminant validity is evaluated by assessing cross-loading values for each variable, with a criterion that values should exceed 0.70 and be higher than other variables (Ghozali and Latan, 2015, p. 74). Reliability testing measures the consistency or stability of respondents' answers over time. In PLS-SEM using Smart PLS 4.0, the reliability of constructs with reflexive indicators is evaluated by computing the composite reliability value. A composite reliability value greater than 0.7 is deemed necessary for confirmatory research, while a range of 0.6 to 0.7 is considered acceptable for exploratory research (Ghozali and Latan, 2015, p. 75).

## 4. RESULTS AND ANALYSIS

Based on the analysis of respondent data, 117 questionnaires were processed, with the majority of respondents being accountants, comprising 22% of the sample. Regarding gender distribution, female respondents accounted for 71%, while male respondents represented 29%. In terms of age, the most significant proportion of respondents fell within the 40-50 age range, constituting 46% of the sample, indicating a predominantly mature demographic. Furthermore, regarding educational attainment, half of the respondents held a master's degree, accounting for 50% of the sample. This data analysis aligns with the study's expectations and objectives, as it indicates that most respondents possess high levels of education and certification as experts, establishing them as knowledgeable individual taxpayers who understand the implications of their tax obligations. Consequently, it is anticipated that their responses to the research questions will contribute to enhancing taxpayer compliance.

### 4.1. Governance Quality in Mediating the Effect of Tax Morale and Tax Knowledge on Tax Compliance

This study examines how governance quality mediates the relationship between tax morale, tax knowledge, and the enhancement of compliance among expert individual taxpayers. The results of the hypothesis testing are provided in Table 1 and Figure 3.

The research model framework test results partially support hypothesis 1, indicating that governance quality can mediate in strengthening taxpayer compliance through their knowledge level. However, regarding tax morale, governance quality is not a mediating variable.

Enhanced tax knowledge correlates with increased compliance among expert individual taxpayers, and governance quality can mediate to strengthen this relationship. These findings corroborate earlier studies by Fallan (1999), Omagor and Mubiru (2008), Manual and Xin (2016), and Newman et al. (2018), which have similarly demonstrated a connection between tax knowledge, compliance, and governance quality highlighting the positive impact of increased tax knowledge.

### 4.2. Tax Compliance in Mediating the Effect of Tax Morale and Tax Knowledge on Governance Quality

The connection between governance quality and tax compliance is reciprocal, suggesting a mutual influence between the two variables. This indicates that each variable can serve as a cause and an effect for the other and vice versa. Damayanti and Supramono

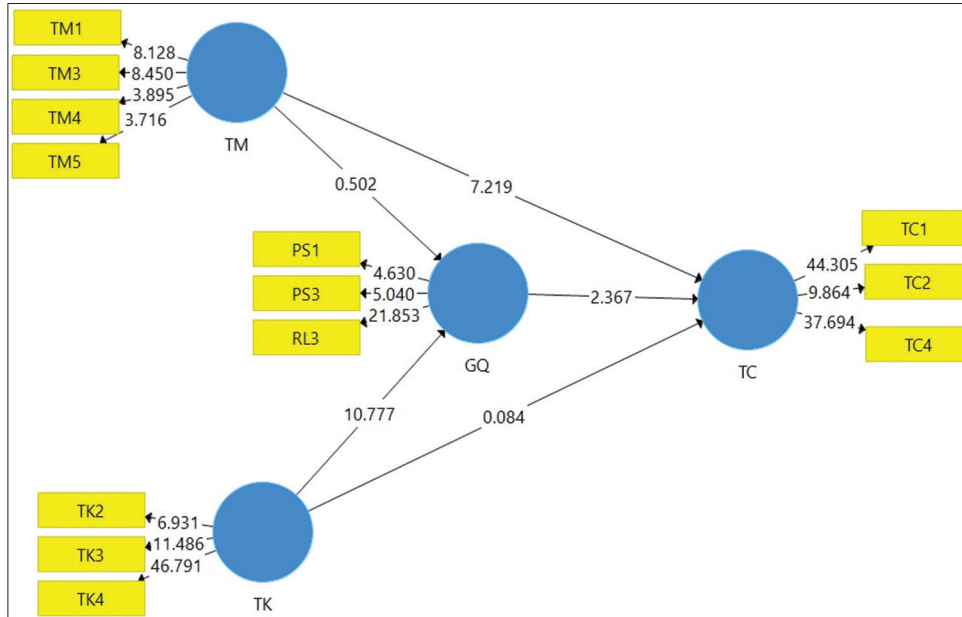
**Table 1: Hypothesis testing model 1**

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics ( O/STDEV )	P values
GQ→TC	0,303	0,275	0,131	2,320	0,021
TK→GQ	0,603	0,612	0,067	9,042	0,000
TK→TC	0,006	0,019	0,078	0,082	0,935
TM→GQ	-0,069	-0,089	0,143	0,481	0,630
TM→TC	0,569	0,575	0,078	7,343	0,000
TK→GQ→TC	0,183	0,166	0,079	2,319	0,021
TM→GQ→TC	-0,021	-0,013	0,036	0,576	0,565

(2019) illustrate that the perception of tax authorities' authority and the dynamic interaction between these variables significantly affect tax compliance. This study looks at the role of tax compliance as a mediating variable that influences tax morale and tax knowledge to improve governance quality. The hypothesis test results are shown in Table 2 and Figure 4.

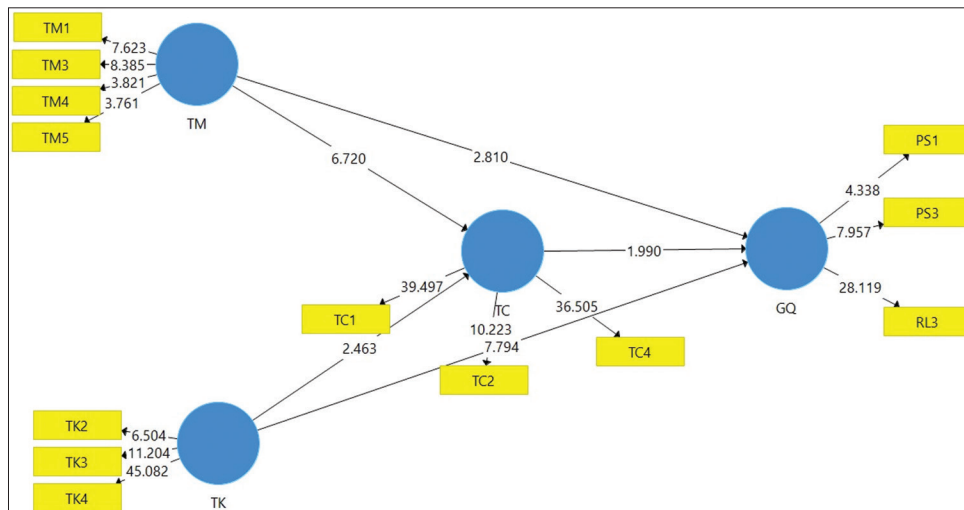
The findings of the research model framework test partially support hypotheses 2 and 3, indicating that tax compliance can serve as a mediating factor in strengthening governance quality through the moral level of taxpayers. However, regarding tax knowledge, tax compliance does not function as a mediating variable. Increased tax morale leads to greater compliance among expert individual

Figure 3: Inner model result model 1



Data source: November 2023

Figure 4: Inner model result model 2



Data source: November 2023

Table 2: Hypothesis testing model 2

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics ( O/STDEV )	P Values
TC→GQ	0,277	0,253	0,139	1,990	0,047
TK→GQ	0,573	0,585	0,074	7,794	0,000
TK→TC	0,189	0,194	0,077	2,463	0,014
TM→GQ	-0,267	-0,278	0,095	2,810	0,005
TM→TC	0,549	0,559	0,082	6,720	0,000
TK→TC→GQ	0,052	0,052	0,036	1,463	0,144
TM→TC→GQ	0,152	0,140	0,082	1,858	0,064

taxpayers. These findings align with the research conducted by Chong and Arunachalam (2018), which similarly concluded that individuals with higher tax morale exhibit a stronger tendency towards compliance and governance quality.

## 5. CONCLUSION

This study aims to examine the existence of a reciprocal relationship between taxpayer compliance and governance quality. Based on the data analysis of the respondent data above, the number of questionnaires processed was 117 respondents, professional individual taxpayers. In the first model, where governance quality serves as a mediating variable, it is demonstrated that it can facilitate the influence of taxpayer knowledge, thus reinforcing taxpayer compliance through governance quality. However, governance quality does not mediate tax morale. In the second model, where taxpayer compliance acts as the mediating variable, it is established that it can facilitate the influence of taxpayer morale, further enhancing governance quality through taxpayer compliance. However, tax compliance does not mediate tax knowledge. Bazart and Bonein (2014) show that reciprocity is significant in addressing tax compliance issues, as it can elucidate the broader patterns of tax evasion on a global scale, transcending individual decisions and potentially leading to either a downward or upward trend in tax compliance dynamics.

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