

INTERACTION TAX INCENTIVES AND TAX AUDIT ON TAX COMPLIANCE

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ABSTRACT

Tax compliance is a factor increasing state tax revenues. Several studies have shown high levels of adherence are influenced by many factors including the services from tax office and knowledge of tax administration. In addition, the policies and rules of taxation may also increasing tax compliance such as regulation about tax incentives on some sectors or regions. The purpose of this study to prove the effect of tax incentives on tax compliance with tax audit as moderating variable.

The study was conducted by distributing questionnaires to the manufacturing, trade and services industries. The first result of the research was able to prove the hypothesis that the tax incentives and the tax audit affect the tax compliance . The second result show that the interaction between tax incentives and tax audit have significant effect on tax compliance. Therefore, both variables need to be used as models in creating policies to improve tax compliance of taxpayers.

Keywords: *tax compliance - tax incentives - tax audit*

1. Introduction

The level of tax compliance in paying taxes in Indonesia is very low. It can be seen through the evident that among 110 million personal taxpayers, only 8.5 million or 7.7% who report to tax office, while for corporate taxpayers are only 3.36% (446,000 corporates) report SPT of 12 million active entities (Republika October 1, 2011). The low ratio of taxpayers who report this SPT requires a review of the various parties to determine the cause.

To increase tax compliance, government is always trying to improve services in many ways, including the tax incentives to provide tax relief in the form of reduction in net income and accelerated tax depreciation for taxpayers investing in certain sectors or certain regions receiving high priority on a national scale (Act 36 of 2008). In addition, other tax incentives are also given to the tax payers such as VAT exemption, Duty free entry, income tax exemption for import, and luxury sales taxes for goods entering to Batam (PP No. 2, 2009). Both this tax incentives are expected to encourage investment climate in in this region that will affect the increasing number of state tax revenue. They are also expected to have other effects such as to increase the willingness to pay other taxes better. Although we know that the tax incentives are still not well socialized and as the result, not all taxpayers know about them.

To improve tax compliance, tax audits factors also need to be explored. Taxpayers who are afraid checked will attempt to obey the tax administration activities, but taxpayers who doesnt know the impact of tax audits usually do not really care that they do not carry out their tax liability properly.

This study aimed to detect the role of tax incentives and tax audits in tax compliance. This is based on research results have not been consistent and the role of tax incentives have not been studied previously. The benefits of this research are expected to provide input to the policy-making related primarily to the importance of tax incentives in order to increase tax compliance which can indirectly increase state tax revenues.

2. Theoretical framework and Hypotheses Development

2.1. Theoretical Framework

Attribution theory developed by Heider (1958) who argued that a person's behavior is determined by a combination of internal forces are factors that exist in a person such as ability or effort and external forces are the factors coming from outside such as the difficulty of the work or luck. This theory was further developed by Jones and Davis (1965), Kelley (1967), and Weiner (1974) who developed this theory as the basis of the theoretical framework that become the paradigm of social psychology for most researchers so that since the 1970s the social psychology research is dominated by attribution theory . The theory becomes relevant theory is used to study perception, perception of events, changes in attitudes, knowledge acquisition personal, therapeutic interventions, and others.

This theory is also widely used in research to determine human perception because this theory assumes that someone is tried to decide why he/she does what he/she does which resulted in a behavior, so the theory is appropriate for use in testing. One of the perception study often done is the perception of tax compliance with the various factors that may affect tax compliance.

2.2. Theory of Planned Behavior (TPB)

Theory of Planned Behavior (TPB) is a model of social psychology is most often used to predict the behavior. TPB is designed to predict and explain human behavior in a specific context. TPB is good behavior prediction as corroborated by the intention to perform the behavior. The intentions are assumed to capture the motivational factors that influence behavior, which indicates how strong the desire to try, or how much work is done in order to implement a behavior. In general, the stronger the intention to do something, it is increasingly possible to achievement behavior (Ajzen, 1991).

The theory of planned behavior postulates three conceptually independent determinants of intention. The first is the attitude toward the behavior and refers to the degree to which a person has a favorable or unfavorable evaluation or appraisal of the behavior in question. The second predictor is a social factor termed subjective norm; it refers to the perceived social pressure to perform or not to perform the behavior. The third antecedent of intention is the degree of perceived behavioral control which, as we saw earlier, refers to the perceived ease or difficulty of

performing the behavior and it is assumed to reflect past experience as well as anticipated impediments and obstacles (Ajzen, 1991).

2.3. Tax Incentives

Providing tax incentives to the taxpayer is intended to ease the tax burden for taxpayers. The tax burden will aggravate the company's operations and can disrupt the taxpayer's cash disbursements. Tax incentives from the government mentioned in regulation number 36 in 2008 on income taxes has already set about tax incentives (section 31 A) in the form of reduction of net income to 30%, accelerated depreciation and amortization, longer loss compensation, and the imposition of income tax on the dividend by 10%. This facility is only granted to taxpayers' investments in certain business areas and / or in the specific areas that receive high priority on a national scale.

Other tax incentives provided are in the form of VAT's exemption and luxury sales's tax exemption for certain industrial zones such as Batam. Exemption of VAT and luxury sales's tax are expected to drive the growth of industry in the region that would affect the new companies interest to investing in the free zone. The tax incentives in the form of tax relief are expected to increase the awareness of tax payers to perform their tax obligations better because of the tax to be paid is not too expensive. The tax incentives is expected to increase taxpayer's compliance.

2.4. Tax Audit

According to the tax laws of article 1 of Law point 24 number 28 of 2007 concerning general provisions of taxation, describes the examination as a series of activities to search for, collect, and process the data and or other information to verify the fulfillment of tax obligations and for other purposes in order to implement tax legislation. The goal of this examination is covering interpretation of the law in the incorrect way, the error counting, embezzlement of income in particular, and cuts and reductions that should not be (Tjahyono and Hussein, 2000).

Trivedi, Shehata, and Mestelman (2005) examined tax compliance through experimentation and questionnaire about tax compliance in hypothetical situation. To detect tax compliance through experiments is by looking at the possibility of taxpayers reported the tax in appropriate way which is manipulated by the possibility of being audited and not audited, along with sanctions if it is audited, and as the result it will impact a reduction of taxpayers.

Moreover, Iyer, Reckers, and Sanders (2010) produced a study that supports the effect of tax audit on tax compliance. They said that the communication of sanctions and increased in visibility of taxation significantly affects tax compliance. This research is also supported by Niu (2011) that produces a positive relationship between audit and voluntary compliance. However, Johnson, Masclet, and Montmarquette (2010) proved that the increased of likelihood audit does not inevitably lead to a reduction in tax evasion.

2.5. Tax Compliance

Alm, Sanchez, and De Juan (1995) conducted experiments to investigate the factors that affect tax compliance, by comparing different experiments for different countries. The results provide experimental evidence that social attitudes towards tax compliance is a significant and measurable impact on individual behavior.

Tax evasion is affected by the social interaction is the result of research conducted by Fortin, Lacroix and Clarie (2004), by conducting experiments using a computer program which aims to test the participants related to reporting their revenue by using the tax rates specified and possibility to audited by using manipulation of information and environmental when participants were left to interact with other participants. The results of the study which tested the effect of the adjustment, the influence of justice, and the effect of this sorting, showed that only the effect of justice are acceptable but for the effect of adjustments and sorting are rejected.

Research on tax compliance has been done by Donna and Richard (2003), by using the theory of planned behavior as a theoretical framework to further expand previous studies that examined tax compliance intentions by

adding moral obligation explicitly to the TPB (Ajzen, 1991). Moral obligation is expected to provide influence moderation on variables that affect tax compliance based on TPB.

In Indonesia also have been done research on tax compliance, one of them is Hartoko and Falikhatun (2009) who examine the effect of motivation, discipline, and education level on adherence of employees to have a Taxpayer Identification Number (TIN) with the sunset policy as an intervening variable. The results show that motivation and discipline have significant effect on adherence want to have a TIN, while the level of education has no effect. It found that the sunset policy able to mediate levels of motivation and discipline to have a TIN.

Other research is doing by Riza and Farid (2009), which examine the impact of attitudes and moral of taxpayers against taxpayer compliance in the banking industry in Surabaya. Research carried out by the method of this survey proved that moral of taxpayer no significant effect on tax compliance, while the attitude of taxpayers significant effect on tax compliance.

Sya'banto (2010), conducted research by experimenting to see how the influence of concern for the information of tax evasion and moral principles on the possibility of tax evasion. The results showed that the understanding of tax evasion can reduce the desire to make tax evasion and tax payers who have high moral principles, his desire to avoid taxes also low.

2.6. Hypothesis Development

Giving tax incentives to taxpayers can such as easiness in implementing tax obligations, for example facilities of tax rates, facilities of tax reports without being sanctioned, tax exemption, and so forth. The provision of these tax incentives is expected to encourage greater tax compliance of taxpayers. Thing like this can be seen from the research Hartoko and Falikhatun (2009) who examine the effect of motivation, discipline, and education level on adherence of employees to have a Taxpayer Identification Number (TIN) with the sunset policy as an intervening variable. The results show that motivation and discipline significant effect on adherence. Sunset policy as one of the policies related to tax incentives can increase the wishes of taxpayer to have a TIN so the researchers believe that the tax incentives impact the tax compliance. So the first hypothesis to be tested is:

H1: The tax incentives have significant effect on tax compliance

Tax compliance also can be caused by the possibility examined by the tax authorities. Possibility to audited does not necessarily able to increase taxpayer compliance directly. Tax compliance will increase if after examined, there is an impact in the form of underpayments and penalties which is quite significant. Research conducted by Ali and Cecil (2001) who proved that the audit rate and penalty rates can be effective in preventing tax noncompliance behavior. Ali and Cecil (2001) also found that increased income and decrease of tax rates can increase tax compliance. So that researchers believe that tax incentives and the tax audit can effect on tax compliance, so the second hypothesis to be tested is:

H2: Tax incentives and tax audit have significant effect on tax compliance.

Several studies about tax audit have been carried out to detect tax compliance, so the researcher want to know more about how the role of the tax audit if viewed his role as a moderating variable. Moderating variables can strengthen or weaken the effect of other independent variables on the dependent variable. Because the variable of tax audit has been believed to affect tax compliance, the researcher wants to study furthermore whether tax audit variable can strengthen or weaken a tax incentives variable. So that the third hypothesis to be tested is:

H3: Tax Incentives significantly influence tax compliance moderated by variables tax audit.

3. Research Methods

3.1. Population and Sample

The population of this research is the companies which is located in Batam, consisting of companies manufacturing industry, trading companies, and service companies. Total population of the companies in Batam are 4006 companies (statistics in 2011).

Researchers used the three types of the companies as a sample, the greater amount come from sample of manufacturing firms include companies engaged in oil and gas, electronics components, and the shipyard. Several sample are service companies and small sample for trading companies. the greater amount come from sample of manufacturing firms because the manufacturing firms is a company with a large enough scale and most were PMA (Foreign Investment) with the number of tax payments is significant.

Sampling was done by purposive sampling method, involving students as a surveyors to distributing questionnaires to companies. The objective of using purposive sampling method is to facilitate the sampling, but the number of data are precise and accurate. The questionnaire was sent to 120 companies, but who filled out questionnaires only 107 companies. The number of sample that can be processed just 103 sample consisted of 85 companies manufacturing, 4 trading companies, 3 shipyard companies, and 11 service companies. Four sample can not be processed due to incomplete answers.

The respondents who filled the questionnaires are the representative of the company like company directors, finance directors, departemen taxes officers, or departement of accounting of the companies. Data from the completed questionnaires obtained information that 13 (thirteen) representation of the financial section includes the chief financial officer, financial managers and finance staff, 66 (sixty six) representation of the departement of accounting includes accounting managers, supervisors and staff of the Accounting, 4 (four) the representation of departement of taxes, 10 (ten) other representations such as logistics, staffing, and marketing, as well as 10 corporate leaders representations include directors, managers, and directors branch. The respondents are considered to be represents their companies in responding to the perception of this study.

3.2. Research Variables

There are three variables used in this study are tax incentives, tax audit, and tax compliance. Tax incentives shown with statements about tax laws concerning tax incentives in Batam such as reduction of net income, accelerated depreciation, loss compensation with longer time, lightening the tax rate, free of import duties, VAT exemption, exemptions luxury sales tax and waivers for payment of tax.

Furthermore, the variable of tax audit is perception about the purpose of the tax audit, the implementation of the tax audit, tax examiner competencies, and perceptions about the legal certainty of the result of the tax audit. Conversely, the variables of tax compliance are statements about the tax incentives as a service in taxes field, tax incentives provide a good image, tax incentives in Batam motivate investors to invest in Batam, the possibility to audited makes tax payers to obey the law, legal certainty of the tax audit, tax auditor competencies and clear procedures to follow-up the tax audit.

To answer the research objectives so the researchers developed a questionnaire that represents the three variables. The questionnaire is adopted from studies related to the research about tax compliance, one of them is Hasudungan (2007) which is modified by the condition of the existing tax incentives in Batam. Before the questionnaire was distributed to respondents, the questionnaire was pilot tested to several Batam Polytechnic lecturers who understand taxes and we obtained several inputs such as inputs for questionnaire sentences that's still ambiguous, error in typing the sentences, and the input about the choice of respondents that can makes the results of this study are as expected.

3.3. Data Analysis Techniques

Data have been obtained from the surveyor then summarized and analyzed by using SPSS version 17. Mechanical analyzes were performed by using regression analysis technique. Regression analysis technique was chosen to test this hypothesis because regression techniques can infer directly the effect of the independent variables used partially or together. Hair et al. (1998) stated that multiple regression is a statistical technique to explain the relationship between the dependent variable with some independent variables. The flexibility and adaptability of the method makes the researchers can see an association of several variables at once easily. Multiple regression can also estimate the predictive ability of a set of independent variables to the dependent variable (Hair et al., 1998). The regression equation used in this study are:

$$\text{Compliance} = \alpha + \beta_1 \text{Incentives} + \varepsilon \quad (\text{E1})$$

$$\text{Compliance} = \alpha + \beta_1 \text{Incentives} + \beta_2 \text{Audit} + \varepsilon \quad (\text{E2})$$

$$\text{Compliance} = \alpha + \beta_1 \text{Incentives} + \beta_2 \text{Audit} + \beta_3 \text{Interaction} + \varepsilon \quad (\text{E3})$$

Description:

Compliance : Taxpayer Compliance

α : Constant

$\beta_1, \beta_2, \beta_3$: Coefficient of regression

Incentives : Perceptions Taxpayer Against Taxation incentives in Batam

Audit : Perceptions Taxpayer Against Tax audit in Batam

Interaction : Interaction Perception Taxpayer against Tax Incentives and Tax Audit

ε : *Residual*

The three equations was formulated because this study want to test the effect of tax incentives and tax audit against tax compliance with the tax audit variables as moderating variable. Moderating variable is the independent variable that will strengthen or weaken the relationship between the other independent variables on the dependent variable.

Prior to regression test done, performed the classic assumption test so that the results of the regression test meet the criteria BLUE (best, linear, Unbiased estimated). Classical assumption test that can be done is data normality test, heteroscedastisity test, and test multicollinearity (Gujarati, 2003). Autokorelasi test was not done because the data were analyzed is cross section data. Further tests by using regression to determine the effect of tax incentives, tax audits, and interaction between tax incentives and tax audits with tax compliance. To test whether there is any effect of tax audit on tax compliance can be seen at a significance level of alpha 5%. If the significance level of regression result is above 5%, it means that the study was not able to prove the influence of each variable were tested and vice versa if the significance level below 5% means that there is a significant influence on the variables-variables tested.

4. Results

4.1 Descriptive Statistics of Research Variables

The final sample of this study were 103 companies. Respondents consists of 83% of manufacture company, 11% of service company, 4% of trade company, 3% of shipyard company. Data and a general description of the respondents is shown in Table 1 and Table 2. Variable of tax Incentives have an average 3.94 shows most respondents answered not too sure of the tax incentives, with a minimum value of 3, which means there are respondents who tend to disagree on tax incentives and the maximum value of 5 means there are respondents who strongly agree with the tax incentives. Variable tax audit and tax compliance shows average that almost same with the variable of tax incentives, namely 3.91 and 3.86, with a minimum value of 2.63 and a maximum value of 5 for tax audit and a minimum value of 3 and a maximum value of 5 for tax compliance. Variable interaction have an average 15.26 shows most respondents answered not too sure of the interaction between variable tax incentives and variable tax audit, with a minimum value of 1 and a maximum value of 24.

4.2 Classical Assumptions Test Results

The results of classical assumption test in the form of test of data normality, Heteroscedastisity test, and multicollinearity test are:

1. Normality test of data done by looking at the graph histogram and normal probability plots. From the histogram chart in figure 1 does not look too skewed to the left or right, this means that the data are normally distributed. To further ensure, by used normal probability plot in figure 2, the spread of data around the diagonal line and follow the direction of the diagonal line, indicating that the regression model distributed normally.
2. Test of Heteroscedastisity performed by test Glejser, glejser test results in table 3 showed a significance level above 5% for the dependent variable, its mean that does not happen heteroscedastisity.
3. Multicollinearity test performed by testing the correlation between the independent variables. The results in table 4 and table 5 indicate that the correlation is weak and far below the point of 1 (One) that shows there is no multikolinearitas between the independent variables. In addition to the correlation test can also be seen from the value of tolerance and VIF, and the results also showed no multicollinearity occurs because the value of tolerance above 0.1 and VIP is below 10.

4.3 Hypothesis Test Results

Hypothesis testing is performed by using regression analysis to estimate and / or predict the population mean or average value of the dependent variable based on the value of the independent variable. Regression test to test the research hypothesis was conducted three times to test three equations to see the effect of the tax audit variables as the moderating variable equation mentioned above. Results of regression the effect of tax incentives on tax compliance can be seen in Table 6, Table 7, and Table 8.

Table 6 shows the constant coefficient 2.469 with a significance level of 0.000 , 0.354 tax incentives with 0.000 significance level well below the 5 % level of confidence, the result supporting the equation 1 and able to prove the hypothesis that tax incentives have significant effect on tax compliance . Table 7 testing the tax incentives and tax audit as independent variables to the tax compliance (Equation 2) , and generate a constant coefficient of 0.859 with a significance level of 0.004 , tax incentives is 0.194 with significance level of 0.001 and the coefficient value for tax audit is 0.573 with a degree of signifikansi 0,000 . The results of Regression testing are still able to answer the influence of tax incentives and tax audit on tax compliance, but the level of significance for tax incentives has decreased even though its value is still well below the 5 % (level of confidence), so the results of this test is able to prove the hypothesis that tax incentives and tax audit have significant effect on tax compliance.

The changes of significant level will be evidenced by looking at how the role of the tax audit to look at the relationship of tax incentives on tax compliance facilities as shown in the test results in Table 8, which is the result of the regression test to answer the regression equation (P3) . Results of the regression coefficients shows the changes of the constant value dropped to 0.681 with a significance level of 0.023 , the tax incentives also dropped to 0.184 with a significance level of 0.002 , the tax audit also fell to 0.563 with a significance level of 0.000 , and the variable of interaction with coefficient value of 0.017 with a significance level of 0.039 . The results of this test indicate that the interaction variables obtained from the multiplication between the average of tax incentive variable with tax audit variable proving that the variable able to moderate the effect of tax incentive variable on tax compliance despite weaken the influence of tax incentive on tax compliance.

4.4 Discussion

The test results indicate that the tax incentive is capable of being a predictor variable to improve tax compliance. Similarly, the tax audit variable are also able to be a predictor to improve tax compliance of taxpayers. After the interaction between the tax incentive and tax audit on tax compliance are also still seen that these variables is still a predictor variable on tax compliance, but further the impact is reduces the ability to predict tax compliance. This suggests that tax audit as moderating variables that weaken the relationship between the other independent variables on the dependent variable.

This condition is contrary to the researcher's expectation, because the tax audit variable should be capable to be moderating variable that strengthens the relationship between the tax incentives and tax compliance because tax

audit will increasing the fearfully of the taxpayers and they will more obedient in carrying out their tax obligations not otherwise taxpayers abiding due to tax incentives, but their compliance will be reduced due to a tax audit. Such conditions may be due to the respondents of this study have not ever been audited so that their perception of tax audit is not like the researcher expected. For further studies need to be considered the respondents who would fill out the questionnaire, for example by use respondents who had been audited.

5. Conclusion, Implication, and limitations

5.1 Conclusion and Implication

The conclusion of this research are:

1. The conclusion of this research are Variable of tax incentive generate positive and significant coefficient on tax compliance. Tax incentives in the form of a reduction in taxable income, accelerated depreciation, compensation of tax loss carry longer, import duty exemption, income tax exemption VAT, and luxury sales tax exemption in Batam, can increase tax compliance of taxpayers. This is indicates that the higher confidence about the tax incentives will increasing the tax compliance.
2. Variable of tax audits also have a positive and significant coefficient on tax compliance so that the higher confidence about the tax audit, would increase the tax compliance.
3. Variable of tax incentives showed positive coefficient decreased significantly with decreasing levels is below 5%. This indicates that the variable of tax audit as moderating variables that weaken the relationship between tax incentive with tax compliance. However, this condition is still able to answer the hypothesis that tax incentive and tax audit have a significant effect on tax compliance.

5.2 Limitations dan Suggestions

The limitations of this study are:

1. There are respondents who do not understand the tax incentive and tax audit that have earned by the company. It's indicated by the respondents who did not fill out the questionnaire at the end of questions about the tax incentive that have been earned. In addition, researchers also did not manage to get the data companies receiving tax relief and the companies that has been audited.
2. The questions in the research instrument may not be able to make the respondents feel that the presence of tax incentive, tax audit will be able to improve tax compliance.

The suggestions for further study are:

1. Researchers should use respondents from companies that receiving tax incentive corresponding Income Tax Act no. 36 Article 31 A "foreign-capital companies that receive tax relief (tax incentives)".
2. Future studies also can use respondents from companies who had been audited their tax report.
3. Future studies may use other methods such as hypothetical analysis instruments is a semi-experimental research instrument because it involves the emotional of respondents so that research results are expected to further strengthen the hypothesis of this study.

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APPENDIX

Table 1 Respondent Demographics

Descriptive Data		Number	Percentage
Sex	Male	38	37%
	Female	65	63%
Age	21-30	46	45%
	31-40	39	38%
	41-50	17	17%
	> 50	1	1%
Position	Finance	13	13%
	Accounting	66	64%
	Tax	10	10%
	Management	4	4%
	Other	10	10%
Type of Company	Manufacture	85	83%
	Trade	4	4%
	Service	11	11%
	Shipyards	3	3%

Table 2 Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Tax Incentives	103	3	5	3.94	.493
Tax Audit	103	2.63	5	3.91	.449
Tax Compliance	103	3	5	3.86	.409
Interaction	103	1.00	24.00	15.26	3.36
Valid N (listwise)	103				

Tabel 3 Glejser Test

Variable	t statistik	Significance
Tax Incentives	0,242	0,809
Tax Audit	-0,373	0,710
Interaction between Tax incentives & Tax audit	0,189	0,851

Table 4 Independen Variable Correlation

Variable	Tax Incentives	Tax Audit	Interaction
Tax Incentives	1.000	-0.078	-0.086
Tax Audit	-0.078	1.000	-0.298
Interaction	-0.086	-0.298	1.000

Table 5 Tolerance and VIF

Variable	Tolerance	VIF
Tax Incentives	0.899	1.112
Tax Audit	0.901	1.110
Interaction	0.981	1.019

Table 6 Regression Test Results: the effect of Tax Incentives on Tax Compliance

Variabel	Regression Coefficient	T Value	Significance
Constant	2,469	8,329	0,000
Tax Incentives	0,354	4,746	0,000

Table 7 Regression Test Results: The effect of Tax Incentives and Tax Audit on Tax Compliance

Variable	Regression Coefficient	T Value	Significance
Constant	0,859	2,988	0,004
Tax Incentives	0,194	3,290	0,001
Tax Audit	0,573	8,858	0,000

Table 8 Regression Test Results: The effect of interaction between Tax Incentives and Tax Audit on Tax Compliance

Variable	Regression Coefficient	T Value	Significance
Constant	0,681	2,305	0,023
Tax Incentives	0,184	3,154	0,002
Tax Audit	0,563	8,817	0,000
Interaction between Tax Incentives and Tax Audit	0,017	2,089	0,039

Histogram

Dependent Variable: Tax_Compliance

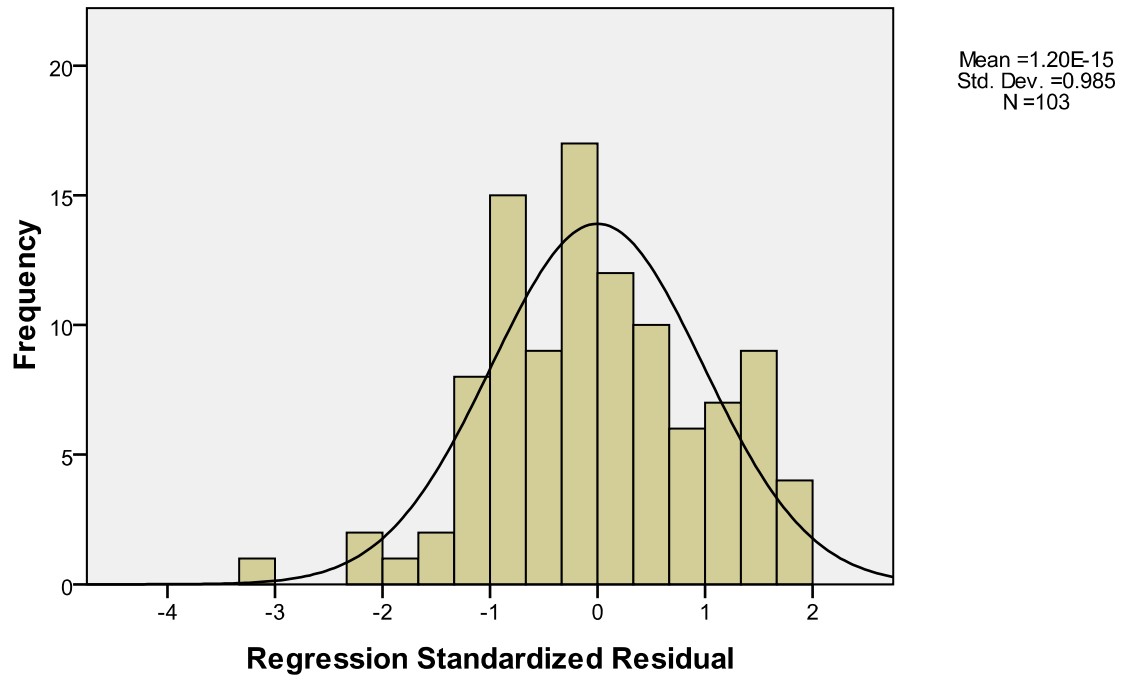


Figure 1. Histogram Graph

Normal P-P Plot of Regression Standardized Residual

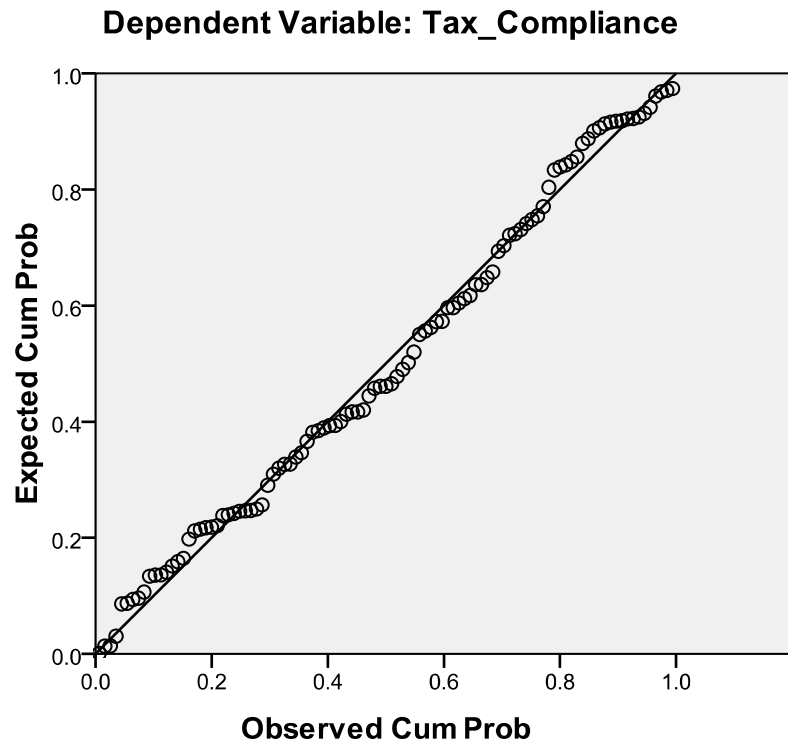


Figure 2. Normal Probability Plot