

# Determinants of Micro Small Medium Enterprises (MSMEs) Tax Compliance

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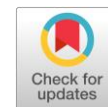
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## ABSTRACT

One of Indonesia's iconic products is teak wood furniture and crafts from Jepara, Central Java. The development of MSMEs operating in this sector is also quite good when seen from the value of exports and domestic turnover. However, this development is different from the level of tax revenue. For the reasons above, this research examines the determinants of tax compliance from this object. A total of 380 MSMEs were involved in this research. Technically, this research uses quantitative methods with Partial Least Squares Structural Equation Modelling (PLS-SEM) analysis. The independent variables used in this research are literacy, tariffs, sanctions, and tax audits, while the dependent variable is tax compliance. The results of direct testing show that tax literacy and tax rates have a positive nexus on tax compliance. Meanwhile, sanctions and tax audits have yet to be proven to affect tax compliance. As the implication of this study, the government could increase tax literacy levels through many channels and review the tariff regularly to enhance MSMEs' tax compliance.



## KEYWORDS

Literacy  
Tariff  
Sanction  
Tax audit  
Tax compliance



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## Introduction

Nearly 40% of MSMEs (Micro, Small, and Medium Enterprises) of the furniture sector in Jepara Regency contribute the highest tax revenue (Fidiyati, 2018). This sector encompasses over 5,800 business units and employs approximately 75,000 workers within Jepara Regency. This substantial involvement presents a significant potential for maximizing taxpayer targets. As a result, MSMEs in the furniture and wooden furniture industry in Jepara Regency play a crucial role in supporting the local economy (Hasanah et al., 2014). Despite other places such as Semarang and Surakarta being established as furniture industry agglomerations, Jepara maintains superior competitiveness due to its distinctive carved furniture (Widiartanti, 2016).

Fidiyati (2018) notes that most of the market value of Jepara Regency MSMEs' furniture industry is derived from Europe, Australia, and America. The Jepara Industry and Trade Service recorded that 42 million kilograms of furniture products were exported to 90 countries, with an export value of USD 186 million in 2022 (Iriyanto & Rohman, 2022). This data underscores the significant economic impact of the Jepara furniture industry on both regional and global scales.

Despite the annual growth of Jepara MSMEs, the number of taxpayers has not corresponded with a proportional increase in tax revenue. Data reveals that taxpayer compliance in the MSME sector regarding annual tax returns has been suboptimal between 2018 and 2022 (Rosyidah, 2022). The compliance ratio for MSME individual taxpayers peaked at 73.8% in 2018. However, this figure decreased to 50.9% in 2019 and continued to decline consecutively in 2020 and 2021 to approximately 39.4%. By 2022, the compliance level had further dropped to 30.1%. The number of taxpayers who submitted reports between 2018 and 2022

was relatively low compared to the total number of registered taxpayers and those required to report. In 2022, out of 14,426 taxpayers required to file reports, only 4,343 complied with their tax reporting obligations.

One key factor contributing to low taxpayer compliance is the public's lack of tax literacy (Risa et al., 2023). Saputro (2020) defines literacy as the ability to receive, understand, and use information to make decisions. Tax literacy, therefore, involves both the knowledge taxpayers possess and the actions they take based on that knowledge (Ibda, 2019). Additionally, many taxpayers feel that they do not see tangible benefits from their tax payments, as evidenced by inadequate infrastructure in Jepara Regency. This sentiment highlights the need for comprehensive efforts to increase tax awareness and concern among the public (Herawati et al., 2022).

To foster tax compliance, taxpayers must understand basic taxation principles, including the imposition of penalties (Rahmayanti et al., 2020). Penalties serve both to correct and to deter non-compliance (Iriyanto & Rohman, 2022), and can help increase tax revenue (Asterina & Septiani, 2019). Tax audits are essential for identifying discrepancies and ensuring compliance (Risa et al., 2023; Wahyudin, 2022). Regular audits promote compliance (Erani & Meiliana, 2016) and inform appropriate tax rates (Putra, 2020). Tax audits ensure tax rates are applied equitably, fostering social balance and prosperity. Reasonably low tax rates are believed to encourage taxpayer compliance by reducing the perceived tax burden (Alshira'h & Abdul-Jabbar, 2020), leading to the voluntary fulfillment of tax obligations.

This persistent decline in compliance underscores the necessity for research focused on Jepara Regency. This study contributes to the existing literature by elucidating the role of tax literacy and tax rates in enhancing tax compliance among MSMEs in Indonesia. It provides empirical evidence that supports the theoretical framework linking tax knowledge and economic incentives to compliance behavior. The findings of this research are expected to be valuable for evaluation purposes and to serve as a reference for government efforts to address tax compliance issues that have similar problems around the world. The findings challenge the effectiveness of sanctions and tax audits in isolation, suggesting that theoretical models should incorporate a more nuanced understanding of the interactions between various determinants of tax compliance.

## Literature Review

### *Theory of Planned Behavior and Its Implication for Tax Compliance*

The Theory of Planned Behavior (TPB) explains that individual behavior is affected by intentions to carry out specific actions. According to Ajzen (1991, 2020), these intentions consist of three components: attitudes (behavioral beliefs), subjective norms (normative beliefs), and perceived behavioral control (control beliefs). TPB posits that outcome beliefs, normative beliefs, and control beliefs collectively shape the intentions of individuals.

In the context of tax compliance, the size of the tax rate is linked to control beliefs, which reflect how motivated individuals are to comply with regulations. Tax rates that are balanced and not overly burdensome for Micro, Small, and Medium Enterprises (MSMEs) can encourage these entities to meet their monthly tax obligations (Pertiwi et al., 2020). The more proportional the tax rates developed by the government, the more likely MSMEs are to report their income to tax authorities. This increased compliance occurs because individuals are more likely to perform a behavior if they feel capable of carrying it out.

Furthermore, TPB explains behavioral control related to tax sanctions through control beliefs, which are assumed to influence taxpayers' intentions to fulfill their tax obligations. Perceived behavioral control encompasses individuals' perceptions of the ease or difficulty of performing a particular behavior, such as complying with tax requirements.

Understanding TPB can thus assist policymakers in designing effective and equitable tax policies and enhancing tax compliance, particularly among MSMEs. This approach underscores the importance of considering taxpayers' perceptions and motivations in developing fair and acceptable tax policies.

According to Alm (1991), tax compliance refers to adherence to legal laws regarding the reporting of income and the payment of taxes. Macdonald and Pyle (2000) state that tax compliance is reflected in the pattern of reported income, whether part or all of the actual income. There are two fundamental tax compliance models: the financial self-interest model and the extended model. The financial self-interest model assumes that each taxpayer is rational and seeks to maximize their income by considering the possibilities identified by the tax authority. In this context, tax rates are recognized as one of the variables affecting tax compliance (Al-Nowaihi & Pyle, 2000; Pudney et al., 2000).

### ***Attribution Theory and Its Implication for Tax Compliance***

Weiner (1995) had traced back the development of attribution theory to the work of four key figures: Heider (1958) who explored dyadic relationships; Edward Jones and his colleagues (Jones and Davis, 1965; Jones and Nisbett, 1972), who focused on dispositional attributions; Kelley (1967), who examined personal interdependence and inferential processes; and Rotter (1966), who studied individual differences in causal perceptions. The application of attributional analysis has extended beyond psychology, as evidenced by various works (Antaki and Brewin, 1982; Graham and Folkes, 1990; Jaspars et al., 1983).

The development of attribution theory could begin with analyzing organizational behavior, subsequently expanding to encompass the interpretation of individual and dyadic phenomena. This trajectory is plausible because the concepts, issues, and ideas inherent to attribution theory are highly applicable to phenomena deeply embedded in organizational contexts (Weiner, 1995).

Robbins and Judge (2008) define attribution as a determinant of the perceived causes underlying an individual's behavior, which can be internal or external. These attributions are influenced by three key factors: specificity, consensus, and consistency. Attribution theory is further applied to elucidate the factors influencing taxpayer compliance, as investigated in the research model by Masrurroh (2013). Taxpayer compliance is intricately linked to individuals' attitudes towards tax assessment. The process of evaluating taxes through interpersonal interactions is thought to be influenced by internal and external attributions assigned to others. Consequently, individuals' interpretations of taxation represent internal factors shaping their fulfillment of tax obligations. Conversely, external factors such as tax audits and sanctions incentivize individuals to fulfill their tax responsibilities effectively.

### ***Hypotheses Development***

Tax literacy contains tax information applied by taxpayers as a reference and guide in acting, making decisions, and taking clear directions or strategies in fulfilling their tax rights and obligations (Zulma, 2020). According to attribution theory, internal and external factors influence a person's behavior when doing something. One of the internal factors comes from a person's understanding of taxes (Nistiana et al., 2022). Individual understanding and knowledge of taxpayers about tax regulations are an internal cause. These are through the control of the taxpayers themselves (Pravasanti & Pratiwi, 2021). Therefore, if an individual taxpayer does not have enough capabilities to understand tax knowledge, then it is likely that the taxpayer does not realize the importance of fulfilling tax rights and obligations (Pravasanti & Pratiwi, 2021). The scale of taxpayers' understanding and knowledge regarding their tax rights and responsibilities can influence taxpayers' decisions to comply with tax regulations under applicable laws (Bernard et al., 2018). If taxpayers feel the benefits of taxation, then awareness within taxpayers will grow by itself because taxpayers think that the rights they have received have been fulfilled, so taxpayers will be more accepting of fulfilling their obligations. Ibda (2019) assumed that knowing taxation means individuals will understand and comprehend tax policies. Therefore, they can increase their awareness of taxation.

Research by Setyawan and Aris (2022) and Lestary et al. (2021) shows that tax understanding affects tax compliance positively. Asterina and Septiani (2019) stated that if taxpayers comprehend taxation better, their awareness of fulfilling their rights will be higher. So, it is said that taxpayers will be more compliant if they have an awareness of and understanding of taxation. Based on this description, the hypothesis is:  
H1. Tax literacy has a positive effect on tax compliance.

Based on Article 59 of Government Regulation Number 55 Year 2022 regarding Adjustment of Regulations in the Field of Income Tax, the government can make a policy by setting a rate of 0.5% for the final income tax (Indonesian Government, 2022). According to the Theory of Planned Behavior, the size of the tax rate is correlated with control beliefs, i.e., how motivated individuals can achieve income and obey the rules. According to Pertiwi et al. (2020), tax rates balanced and do not burden MSMEs can encourage taxpayers to fulfill their monthly tax obligations. The results of this study are contrary to a study conducted by Alshira'h et al. (2021), in which tax rates have an insignificant relationship with sales tax compliance in Jordan. It is assumed that proportional tax rates will make MSMEs more compliant in reporting their income to the fiscus (Julianto, 2017). The purpose of implementing this regulation is to provide relief to individual taxpayers, especially taxpayers in the MSME sector, educate the public about administrative order, and participate in the deployment of development in the taxation sector (Hadiwibowo et al., 2023). So, the final result is also expected to increase tax compliance. Research by Sandra and Chandra (2020) and Okpeyo et al. (2019) shows that tariffs are a fundamental factor in increasing taxpayer compliance. According to Allingham and Sandmo (1972), tax rates have a significant positive nexus on tax compliance. Based on this statement, the hypothesis is:

H2. Tax rates have a positive effect on tax compliance.

The utilization of taxes to finance state and public needs is integral to enhancing the quality of tax compliance in state financing (Rahmayanti et al., 2020). According to the Theory of Planned Behavior, tax sanctions affect control beliefs about the perception of taxpayers' ability to perform actions. Consequently, stringent and orderly imposition of tax sanctions can exert a deterrent effect (Oladipupo & Obazee, 2016). In the context of attribution theory, tax sanctions are nexus to taxpayer behavior influenced by external factors. Hence, penalties serve as a critical mechanism in educating violators of tax regulations. Taxpayers are more likely to comply with tax obligations if the sanctions result in substantial financial repercussions.

Research conducted by Karnedi and Hidayatulloh (2019) and Yuliatic and Fauzi (2020) demonstrates that tax sanctions significantly influence taxpayer compliance. These sanctions are applied to ensure strict adherence to regulations or laws. As Brata et al. (2017) suggest taxpayers are more likely to fulfill their tax obligations if they perceive the sanctions imposed will be highly detrimental. Therefore, the stricter the enforcement of sanctions, the greater the level of taxpayer compliance. Allingham and Sandmo (1972) also established a significant relationship between tax sanctions and taxpayer compliance. Based on this discussion, the hypothesis developed as follows:

H3. Tax sanctions have a positive effect on tax compliance.

As stipulated in Article 1 (25) of Act Number 16 Year 2009, tax audits are regarded as an effective measure to enhance tax compliance (Indonesian Government, 2009). A tax audit involves a series of activities purposed at collecting and processing data, information, and evidence objectively and professionally based on audit standards to verify tax obligation fulfillment and other purposes by tax laws and regulations. Harelimana (2018) defines a sales tax audit as a systematic review and monitoring of records, invoices, and tax reports for individuals registered for sales tax or those who sell taxable goods and services. Harelimana (2018) posits that tax audits are among the most effective tools for preventing tax non-compliance. Attribution theory also relates to tax audits, emphasizing that the compliance behavior of taxpayers is affected by external factors, such as audits conducted by authorized parties. Previous studies by Alshira'h and Abdul-Jabbar (2020) and Asterina and Septiani (2019) Found that tax audits positively impact tax compliance. Audits are applied to minimize discrepancies such as tax evasion, underpayment, or overpayment of taxes, which lead to non-compliance. According to Okpeyo et al. (2019), tax audits ensure the thorough completion of tax reports, as any inconsistencies detected can result in penalties. Therefore, taxpayers who are routinely audited tend to comply more voluntarily to avoid detection during audits, thereby reducing tax non-compliance (Erani & Meiliana, 2016). Based on attribution theory and previous research, the following hypothesis can be proposed:

H4. Tax audits have a positive effect on tax compliance.

## Research Method

The type of research applied in this study is associative quantitative research to examine five variables using a questionnaire survey design (Sugiyono, 2012). This study applied Partial Least Squares Structural Equation Modelling (PLS-SEM).

In this research, primary data is taken directly from respondents via questionnaires with three criteria, i.e., 1. MSME players in the furniture industry in Jepara Regency, 2. MSME players who have a Tax Identification Number, or *Nomor Pokok Wajib Pajak* (NPWP), 3. MSMEs have been established for at least one year.

The population of this research is the number of MSME actors in the Jepara Regency furniture industry, totaling around 5,800 taxpayers, according to data from the Jepara Regency Industry and Trade Service. The sample size in this study was determined using the Slovin formula with the following 5% error level. Therefore, the minimum number of samples needed for this research is 380 respondents.

This study used one endogenous variable, namely tax compliance. In contrast, four exogenous variables are used, i.e., tax literacy, tariff, sanction, and tax audit. Table 1 explains the definition of each variable and its measurements.

## Data Analysis Techniques

### Outer Model

*Validity Test:* Validity measures whether a questionnaire can reveal what it aims to measure. Validity is tested by examining the correlation between item scores and the total variable. The questionnaire is valid if the calculated r-value exceeds the table r-value and is positive. There are two types of validity tests: convergent validity (loading factor > 0.5) and discriminant validity (indicator's loading factor greater than cross-loading value) (Ghozali & Latan, 2015).

*Reliability Test:* Conducted on valid questions to measure the consistency of measurement results. It uses composite reliability and Cronbach's alpha ( $\alpha$ ). A variable is considered reliable if the Cronbach's Alpha > 0.6 (Ghozali & Latan, 2015).

### Inner Model

*Assessing R-square:* Part of the coefficient of determination test determines the influence of independent variables on the dependent variable. The R-square value measures the variation level of changes in the independent variable relative to the dependent variable. R-square values: 0.75 (strong), 0.50 (moderate), 0.25 (weak) (Ghozali & Latan, 2015).

*Testing Relationships Between Variables:* Hypothesis testing to determine the influence and significance of independent variables on the dependent variable using the bootstrap resampling method. The impact is significant if p-values < 0.05 or t-statistics < 1.96 (Ghozali & Latan, 2015).

## Results and Discussion

### Data Presentation

This research involved 380 respondents as samples. All respondents have a Tax Identification Number or *Nomor Pokok Wajib Pajak* (NPWP). The research sample was in Jepara Regency, spread across 13 sub-districts, applying purposive sampling techniques. The most significant respondents came from the Jepara District, namely 151 MSMEs (39.74%), and the Annual District with 128 MSMEs (33.68%). The fewest respondents came from Kalinyamatan District, Keling District, Nalumsari District, and Pecangaan District, each one MSME actor (0.26%). Detailed data can be seen in Figure 1.

**Table 1. Operational Definition of Variable**

Variable	Definition	Indicator/ Reference	Total Item of Statement	Scale
<b>Endogenous Variable</b>				
Tax Compliance	Compliance in filing tax returns, reporting and paying the correct amount of tax on time, and complying with goods and services tax laws and administration.	Tax obligation fulfillment (Rahmayanti <i>et al.</i> , 2020)	4	Likert Very disagree – very agree 1-5
<b>Exogenous Variable</b>				
Tax Literacy	Tax literacy is how an individual understands what can or cannot be done related to tax provisions (Anggini <i>et al.</i> , 2021).	Tax System Comprehension (S. K. Rahayu, 2010)	3	Likert Very disagree – very agree 1-5
Tariff	Tariffs are one of the main determinants in the structure of the tax system and one of the main factors related to tax compliance (Richardson, 2006).	Tariff Fairness (Sudirman & Amiruddin, 2012, modified)	4	Likert Very disagree – very agree 1-5
Sanction	a form of punishment for non-compliance in carrying out tax obligations (Wulandari <i>et al.</i> , 2023)	Enforcement of Sanction (Oladipupo & Obazee, 2016, modified)	3	Likert Very disagree – very agree 1-5
		Fair Sanction (Oladipupo & Obazee, 2016, modified)	1	Likert Very disagree – very agree 1-5
Tax Audit	series of gathering activities and processing data, information, and/or evidence carried out objectively and professionally based on an inspection standard to test compliance with tax obligations and/or for other purposes to carry out provisions of tax laws and regulations. (Indonesian Government, 2007)	Legal Basis (Erani & Meiliana, 2016, modified)	1	Likert Very disagree – very agree 1-5
		Independence (Erani & Meiliana, 2016, modified)	1	Likert Very disagree – very agree 1-5
		Enforcement (Erani & Meiliana, 2016, modified)	2	Likert Very disagree – very agree 1-5

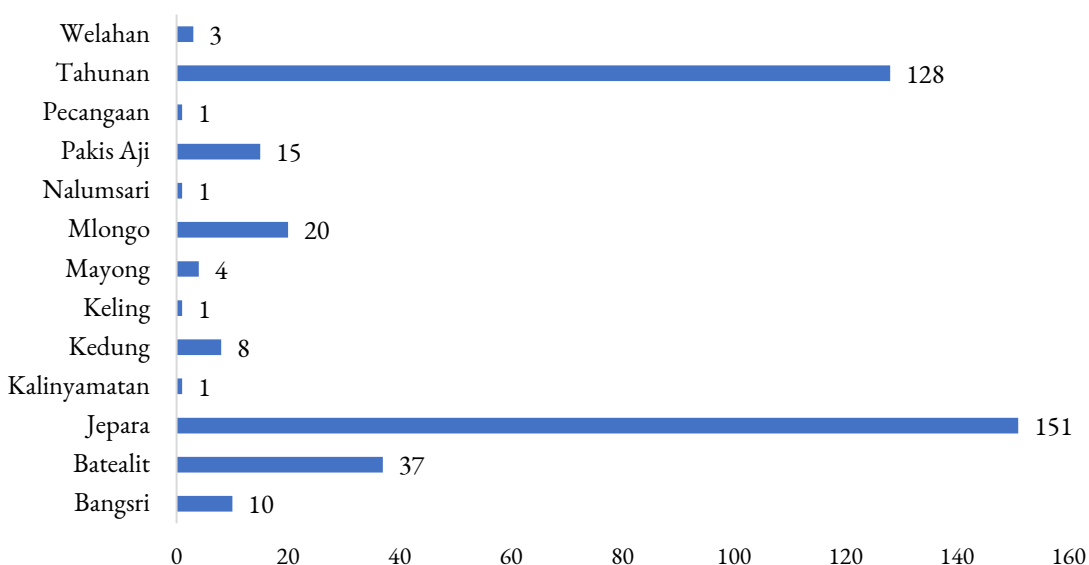


Figure 1. Respondent Distribution

From a demographic perspective, as shown in Figure 2, the sample data reveals that the predominant enterprises have been operational for over a decade. Specifically, 279 MSMEs, comprising 73.42% of the sample, have a business tenure exceeding ten years. Additionally, 93 MSMEs, or 24.47% of the sample, have been established within the 5 to 10 years of timeframe, while a smaller subset of 8 MSMEs, constituting approximately 2.11% of the total sample, are in their nascent stage, operating for less than five years.

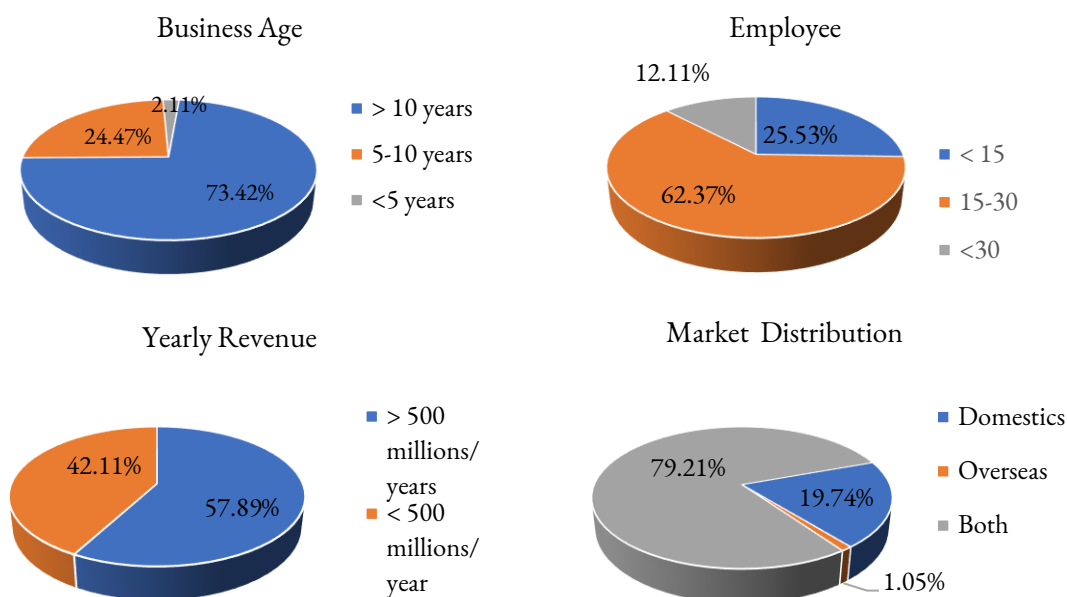


Figure 2. Respondent Demography

Regarding staffing, the distribution is categorized into three segments. The highest proportion, comprising 237 MSMEs or 62.37% of the total, falls within the 15-30 employee range. Furthermore, 97 MSMEs, accounting for 25.53% of the sample, have personnel of at least 15 employees. Conversely, the category with the fewest representation involves MSMEs employing over 30 individuals, totaling 46 enterprises or 12.11% of the sample population.

In terms of revenue, two distinct brackets are identified. A majority, encompassing 58% of the sample or 220 MSMEs, generates annual income exceeding 500 million. Conversely, 42% of the sample, represented by 160 MSMEs, records annual revenues below this threshold.

Market distribution analysis reveals diverse shipping practices among MSMEs. Specifically, 75 enterprises, constituting 19.74% of the sample, exclusively engage in local shipments within Indonesia. Conversely, a minority of 4 MSMEs exclusively focus on international exports without domestic distribution. The predominant strategy, observed in 301 MSMEs or 79.21% of the sample, involves dual operations, encompassing domestic shipments within Indonesia and international export ventures.

In terms of turnover, it is categorized into two. 58% of the total sample, or 220 MSME entrepreneurs, generate income above 500 million annually. The remaining 42%, or 160 MSMEs, have annual revenues below 500 million. Based on market distribution, 75 MSME entrepreneurs, or 19.74%, only ship domestically within Indonesia, 4 MSME entrepreneurs solely export abroad without domestic shipment, and 301 MSME entrepreneurs, or 79.21%, engage not only domestic shipments within Indonesia but also export shipments abroad. Descriptive statistics of this data are displayed in Table 2. This study utilizes both primary and secondary data. Primary data was collected through a survey instrument distributed to key stakeholders in the sustainable finance landscape. These stakeholders encompass regulators (Bank of Indonesia and Financial Services Authority), Islamic banking practitioners, representatives from the Coordinating Ministry for Economic Affairs of the Republic of Indonesia, Amil Zakat National Agency or *Badan Amil Zakat Nasional* (BAZNAS), The National Committee for Islamic Economy and Finance or *Komite Nasional Ekonomi Keuangan Syariah* (KNEKS), and academicians. The primary data serves to identify priority strategies and the most impactful challenges hindering the implementation of sustainable finance within Islamic banks.

**Table 1. Descriptive Statistics**

	N	Minimum	Maximum	Mean	Std. Deviation
Tax Literacy	380	5.00	20.00	16.2711	2.47578
Tariff	380	4.00	20.00	15.9026	2.87992
Sanction	380	10.00	30.00	24.0132	3.97184
Tax Audit	380	4.00	20.00	16.1763	3.09617
Tax Compliance	380	13.00	30.00	24.5658	3.83201
Valid N (listwise)	380				

Source: Primary Data Processed, 2024

**Validity and Reliability Test**

Based on Tables 3 and 4, it can be seen that the data is valid and reliable. In the discriminant validity test results in Table 3, the Average Variance Extracted (AVE) square root value for each latent variable was compared to the correlation values between that latent variable and other latent variables. The square root of the AVE for each latent variable was greater than the correlation values between that latent variable and other variables. Therefore, the requirements for discriminant validity are met.

**Table 3. Discriminant Validity Test**

	X1	X2	X3	X4	Y
X1	(0.695)				
X2	0.048	(0.685)			
X3	0.076	0.046	(0.650)		
X4	0.149	0.103	0.062	(0.744)	
Y	0.057	0.129	0.065	-0.012	(0.691)

Source: Primary Data Processed, 2024



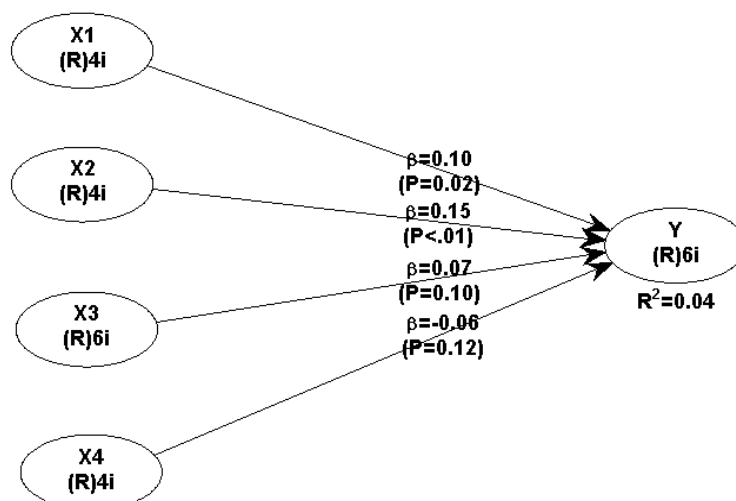
The instrument's reliability was assessed using Cronbach's alpha and Composite Reliability values. A Cronbach's alpha value is considered reliable if it is greater than 0.60, while a Composite Reliability value is considered reliable if it is greater than 0.70. In Table 4, the Cronbach's alpha values for each variable are greater than 0.60. Additionally, the Composite Reliability values for each variable are greater than 0.70. Thus, based on these results described in Table 4, it can be concluded that the instrument used in this research is reliable.

**Table 4. Reliability Test**

Variable	Cronbach's Alpha	Composite reliability
Tax Literacy (X1)	0.641	0.788
Tariff (X2)	0.622	0.779
Sanction (X3)	0.726	0.814
Tax Audit (X4)	0.727	0.831
Tax Compliance (Y)	0.780	0.846

Source: Primary Data Processed, 2024

### Hypothesis Testing



**Figure 3. Research Model Output**

Figure 3 shows the analysis output using Partial Least Square. In this figure, the P-value for each variable can indicate the significance level of the relationship between endogenous and exogenous variables. To clarify the analysis results, they are presented in Table 5.

**Table 5. Hypothesis Test**

Path	Path Coefficients	P-values	Result
X1->Y	0.103	0.021	Accepted
X2->Y	0.151	0.001	Accepted
X3->Y	0.067	0.095	Rejected
X4->Y	-0.059	0.122	Rejected

Source: Primary Data Processed, 2024

Testing the first hypothesis (H1), the determination of tax literacy on tax compliance shows that tax literacy has a positive nexus on tax compliance. The direct tax literacy testing results obtained a path

coefficient of 0.103 and a significance value with a P value of  $0.021 < 0.05$ . Thus, the determination of tax culture on compliance with tax regulations is justified, or hypothesis (H1) is supported.

Testing the second hypothesis (H2) of the determination of tax rates on tax compliance shows that tax rates have a positive nexus on tax compliance. The test results of direct tax rates on direct tax compliance were obtained from a path coefficient of 0.151 with significance at a P value of  $0.001 < 0.05$ . Thus, the result supports the hypothesis (H2).

Testing the third hypothesis (H3) The determination of tax sanctions on tax compliance states that tax sanctions have a negative nexus with tax compliance. The results of direct testing of tax sanctions on tax compliance were directly obtained from a path coefficient of 0.067 with a significance value of P value  $0.095 > 0.05$ . The determination of tax sanctions on tax compliance as a hypothesis (H3) is thus not supported.

Testing the fourth hypothesis (H4) The determination of tax audits on tax compliance states that tax audits have a negative nexus with tax compliance. The results were obtained directly from a path coefficient of -0.059 with a significant value at P-value  $0.122 > 0.05$ . Thus, the determination of tax audits on tax compliance as a hypothesis (H4) is not supported.

## **Discussion**

### *The Nexus of Tax Literacy on Tax Compliance*

Grounded in the attribution theory posited by Robbins and Judge (2008), individual behavior is intricately influenced by many internal and external factors. Among these, an individual's comprehension of taxation emerges as a critical internal determinant (Nistiana et al., 2022). Tax literacy, representing an internal factor, resides within the sphere of the taxpayer's control (Pravasanti & Pratiwi, 2021). The depth of a taxpayer's understanding of tax regulations significantly shapes their inclination to comply with tax statutes under applicable laws (Bernard et al., 2018).

Synthesizing theoretical frameworks with empirical findings elucidates a notable correlation between tax literacy and taxpayer compliance. This alignment substantiates the assertions of Robbins and Judge (2008), emphasizing the integral relationship between tax comprehension, adherence to tax laws, and taxpayer compliance, as corroborated by Bernard et al. (2018). Furthermore, complementary findings from Setyawan and Aris (2022) and Lestary et al. (2021) underscore the constructive impact of tax literacy on fostering tax compliance. Tax literacy serves as a conduit for taxpayers to grasp the intricacies of tax regulations, thereby augmenting their commitment to fulfilling tax obligations. Consequently, an enhanced understanding of taxation fosters heightened compliance among taxpayers.

### *The Nexus of Tax Rates on Tax Compliance*

Embedded within the Theory of Planned Behavior posited by Ajzen (1991) is the notion that tax rates significantly influence individuals' control beliefs, thereby shaping their motivation to comply with tax regulations. Pertiwi et al. (2020) argue that judiciously balanced tax rates alleviate fiscal burdens on Micro, Small, and Medium Enterprises (MSMEs), incentivizing timely fulfillment of tax obligations. This assertion is congruent with the theoretical underpinnings, as tax rates determine taxpayers' adherence to tax duties.

Consistency with the tenets posited by Ajzen (1991) finds empirical support, affirming the substantive impact of tax rates on compliance behaviors, particularly within the context of MSMEs. Insights gleaned from Okpeyo et al. (2019) corroborate the assertion that tax rates exert a discernible influence on compliance behaviors, especially within the purview of MSMEs. Additionally, Sandra and Chandra (2020) study accentuates the pivotal role of tax rates in bolstering taxpayer compliance. A meticulously crafted tax regime, characterized by balanced tax rates devoid of undue fiscal strain on MSMEs, catalyzes fortifying taxpayer adherence to tax obligations (Pertiwi et al., 2020). Consequently, governmental interventions aimed at ameliorating tax rates, such as implementing expansionary fiscal policies involving tax rate reductions, emerge as instrumental measures to stimulate economic activity and enhance taxpayer compliance (P. A. Rahayu et al., 2022).

### *The Nexus of Tax Sanctions on Tax Compliance*

The Theory of Planned Behavior proposed by Ajzen (1991) posits that tax sanctions are closely related to control beliefs, which reflect an individual's perspective on taking action. Therefore, the firm and orderly imposition of tax sanctions can serve as a deterrent, thereby enhancing taxpayer compliance (Oladipupo & Obazee, 2016). From the perspective of Attribution Theory, tax sanctions are external factors influencing taxpayer behavior. Contrary to the theoretical expectations, the hypothesis testing conducted in this study indicates that tax sanctions do not significantly impact taxpayer compliance. According to the Indonesian General Taxation Provisions (KUP) Law, tax criminal sanctions include imprisonment ranging from a minimum of six months to a maximum of six years and fines ranging from two to four times the amount of unpaid or underpaid tax (Presiden RI, 2007). The statement of (KUP) Law suggests that the prescribed punishments for non-compliance must be sufficiently stringent to instill a sense of deterrence among non-compliant taxpayers, thereby failing to enforce compliance.

The findings of this research diverge from those of Alshira'h et al. (2021); and Alshira'h and Abdul-Jabbar (2020), who reported that tax sanctions positively and significantly affect tax compliance. Similarly, research by Ermawati and Afifi (2018) found no significant impact of tax sanctions on taxpayer compliance, attributing this to potential issues such as tax fraud. This perspective is further supported by Karlina and Ethika (2021) and Indrasari et al. (2020), who also concluded that tax sanctions do not significantly influence taxpayer compliance. Taxpayers often perceive the sanctions as inconsequential, leading to negligence in fulfilling their obligations. Many MSMEs consider the tax rates manageable and thus are not deterred by potential sanctions for late payments. Consequently, there is a need for the government to review and possibly strengthen the sanctions imposed on tax violators to enhance their effectiveness (Indrasari et al., 2020; Karlina & Ethika, 2021).

### *The Nexus of Tax Audits on Tax Compliance*

Harelimana (2018) defines a sales tax audit as a systematic review and monitoring of records, invoices, and tax reports of individuals or entities registered for sales tax or those selling taxable goods and services. Harelimana (2018) asserts that tax audits are among the most effective mechanisms to prevent non-compliance with tax (Harelimana, 2018). According to the attribution theory articulated by Robbins and Judge (2008), tax audits are external factors influencing taxpayer behavior.

Similar to the tax sanctions findings, this study's hypothesis testing reveals that tax audits do not significantly determine taxpayer compliance. MSME taxpayers often believe low turnover results in minimal tax obligations, leading to a lack of rigorous adherence to established tax procedures and regulations. This finding contrasts with the results of Rahmayanti et al. (2020), who reported a positive effect of tax audits on taxpayer compliance. Additionally, research by Riyadi et al. (2021) and Muhammad and Sunarto (2018) found that tax audits do not have a significant effect on taxpayer compliance.

According to the KUP Law, the primary purpose of tax audits is to assess compliance with tax obligations and ensure the implementation of tax regulations. However, practically, MSME actors often need more awareness or indifference towards these audits. Monica and Andi, (2019) suggest that tax audits would be more effective if targeted at taxpayers who indicate fraudulent activity in reporting their taxable income.

## **Conclusion**

After researching aspects that influence taxpayer compliance with furniture MSMEs in Jepara Regency, the conclusion is that tax literacy and tax rates influence taxpayer compliance. Meanwhile, the government can improve taxpayer compliance by enhancing public awareness and understanding of taxation through impactful socialization efforts. By providing targeted outreach and counseling on taxation, the expectation is that the intention, comprehension, and awareness of taxpayer compliance can be enhanced, leading to better adherence to tax obligations. Additionally, the research demonstrates the impact

of tax rates on taxpayer compliance, suggesting that policymakers should conduct studies to establish fair tax rates that do not overly burden MSMEs. Notably, this study found that the variables of sanctions and audits did not have a significant influence. Meanwhile, sanction and audit enforcement become crucial aspects that need to be considered. This study advances the literature by clarifying how tax literacy and tax rates influence tax compliance among MSMEs in Indonesia, providing empirical support for the theoretical link between tax knowledge, economic incentives, and compliance behavior. The findings challenge the standalone effectiveness of sanctions and tax audits, suggesting that theoretical models should better account for the interplay of various compliance determinants. For practitioners and policymakers, the research underscores the need for enhanced tax literacy and revised tax rates to improve compliance. It advocates for targeted educational programs and tax rate adjustments as potentially more effective than relying solely on sanctions and audits, offering guidance for developing more effective tax policies and compliance strategies suited to the MSME sector in Indonesia.

Tax literacy relates to disseminating information and knowledge about taxation to the public. Based on this consideration, future researchers could incorporate variables about media and tax socialization techniques as part of their studies. Similar research is also relevant in regions with a high number of MSMEs. Future research could also explore this theme using qualitative methods. This approach is pertinent as SMEs exhibit unique and continually evolving characteristics. Therefore, grounded theory is essential for advancing subsequent research.

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