THE EFFECT OF TAX UNDERSTANDING AND AWARENESS ON MSME TAX COMPLIANCE

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ABSTRACT
This study investigates the effect of tax understanding and taxpayer awareness on compliance with Final Income Tax among Micro, Small, and Medium Enterprises (MSMEs) in Padang Panjang, Indonesia. The research applies a quantitative method using primary data obtained from 41 MSME taxpayers and analyzed using Structural Equation Modeling–Partial Least Squares (SEM-PLS). The results reveal that tax understanding has a statistically significant positive effect on tax compliance, indicating that higher levels of technical knowledge substantially improve compliance behavior. Conversely, taxpayer awareness does not show a significant influence, suggesting that awareness alone does not necessarily translate into compliant actions. The coefficient of determination (R^2) of 0.67 demonstrates that the model explains a considerable proportion of compliance variability. These findings emphasize the importance of strengthening practical tax literacy rather than relying exclusively on normative awareness campaigns.
***Keywords**: Tax Understanding, Taxpayer Awareness, Tax Compliance, Msmes.*

INTRODUCTION

Taxation constitutes a fundamental instrument for financing public expenditure and fostering national economic development, particularly in developing economies such as Indonesia where tax revenue represents the dominant source of government income (OECD, 2021; World Bank, 2020). Within this framework, Micro, Small, and Medium Enterprises (MSMEs) play a critical role, not only due to their substantial contribution to gross domestic product but also because of their capacity to absorb labor and stimulate regional economic growth (Tambunan, 2019; Ministry of Cooperatives and SMEs, 2022). Despite their significant economic presence, MSMEs often exhibit relatively low levels of tax compliance, thereby limiting their potential contribution to national revenue generation (Devos, 2014; Kirchler, 2007).

In the specific context of Padang Panjang, empirical evidence demonstrates a paradoxical condition in which the number of MSMEs continues to grow while the level of tax compliance shows a declining trend. This phenomenon indicates the existence of structural and behavioral challenges in the implementation of tax policies, particularly those related to the self-assessment system, where taxpayers are responsible for calculating and reporting their own tax liabilities (Mardiasmo, 2019; Waluyo, 2021). Although the government has introduced simplified tax schemes such as the final income tax rate of 0.5 percent under Government Regulation No. 23 of 2018, these measures have not fully succeeded in improving compliance rates. This suggests that the issue extends beyond policy design and involves deeper behavioral and cognitive factors (Alm, 2019; OECD, 2021).

From a theoretical perspective, taxpayer compliance is influenced by both cognitive factors, such as understanding of tax regulations, and psychological factors, such as awareness and moral obligation (Ajzen, 1991; Kirchler, 2007). However, prior empirical studies present inconsistent findings regarding the relative importance of these variables, thereby creating a research gap that warrants further investigation. Some studies emphasize the role of tax knowledge in facilitating compliance, arguing that well-informed taxpayers are more likely to comply voluntarily (Saad, 2014; Wahang et al., 2025). In contrast, other studies highlight the importance of awareness and attitudinal factors, suggesting that moral responsibility and trust in government are key drivers of compliance behavior (Feld & Frey, 2007; Torgler, 2005).

In response to this research gap, this study aims to analyze the influence of tax understanding and taxpayer awareness on MSME tax compliance using a structural equation modeling approach. By focusing on a localized context, this research contributes not only to empirical literature but also provides practical insights for policymakers in designing more effective tax compliance strategies, particularly in strengthening tax education and behavioral interventions (Alm, 2019; OECD, 2021).

METHODS PENELITIAN

This study employs a quantitative research design with an explanatory approach to examine causal relationships between variables. Primary data were collected through structured questionnaires distributed to MSME taxpayers in Padang Panjang. The population consists of 13,286 MSME units, from which a sample of 41 respondents was selected using purposive sampling based on specific criteria, including active business operation and possession of a tax identification number.

The constructs measured in this study include tax understanding as a cognitive variable, taxpayer awareness as a psychological variable, and tax compliance as a behavioral outcome. Each construct is operationalized using multiple indicators measured on a Likert scale ranging from one to five, ensuring a comprehensive representation of each latent variable.

Data analysis is conducted using Structural Equation Modeling–Partial Least Squares (SEM-PLS), which is particularly suitable for small sample sizes and complex models involving latent constructs. The analysis is performed in two stages. The first stage involves evaluating the outer model to assess the reliability and validity of the measurement instruments. The second stage involves evaluating the inner model to examine the structural relationships between variables and test the proposed hypotheses.

RESULTS AND DISCUSSION

Descriptive Findings

The descriptive analysis reveals that the overall level of tax compliance among MSME taxpayers in Padang Panjang can be categorized as relatively high, reflecting a general tendency among respondents to fulfill their tax obligations such as calculating, paying, and reporting taxes. This finding is consistent with the view that compliance behavior can be initially shaped by regulatory frameworks and administrative systems that encourage formal participation (Mardiasmo, 2019; Kirchler, 2007). Nevertheless, a deeper examination indicates that this compliance is not yet fully consistent, as some respondents still experience difficulties in maintaining timely and accurate reporting practices. Such inconsistencies are commonly observed in self-assessment systems, where taxpayers are required to independently manage their obligations without continuous supervision (Waluyo, 2021; Alm, 2019).

Tax understanding among respondents is also categorized as high; however, this classification should be interpreted cautiously, as several indicators suggest that the level of understanding remains largely superficial. Many respondents demonstrate adequate knowledge of basic tax concepts, such as the existence of final tax rates, but encounter challenges when dealing with more technical aspects, including tax calculation procedures, reporting mechanisms, and the use of digital tax systems. This condition aligns with previous findings indicating that conceptual understanding does not necessarily translate into procedural competence, particularly among small business taxpayers with limited formal training in accounting or taxation (Saad, 2014; Devos, 2014). Therefore, the effectiveness of tax policies depends not only on awareness but also on the depth and applicability of taxpayer knowledge.

Taxpayer awareness appears to be relatively well developed, particularly in terms of recognizing the importance of taxes for national development and public welfare. However, the findings suggest that this awareness is predominantly normative in nature and does not always manifest as concrete compliance behavior. This discrepancy highlights the distinction between awareness as a cognitive acknowledgment and compliance as an actionable behavior. According to behavioral tax theory, awareness alone is insufficient to drive compliance unless it is accompanied by perceived capability and practical understanding (Ajzen, 1991; Torgler, 2005). Consequently, taxpayers may express agreement with the importance of taxation while still failing to fully comply due to limitations in knowledge, skills, or administrative capacity.

Measurement Model Evaluation

Table 1. Construct Reliability and Validity

Construct	Cronbach's Alpha	Composite Reliability	AVE
Tax Compliance	0.89	0.92	0.6
Tax Understanding	0.91	0.93	0.62
Tax Awareness	0.88	0.91	0.58

The results of the reliability and validity tests indicate that all constructs meet the required thresholds, confirming that the measurement model is robust and suitable for further analysis. The high values of Cronbach's Alpha and Composite Reliability demonstrate strong internal consistency among the indicators, while the Average Variance Extracted values above 0.50 indicate that each construct can explain a substantial portion of its indicator variance.

Structural Model Evaluation

Table 2. Coefficient of Determination

Variable	R^2	Interpretation
Tax Compliance	0.67	Moderate

The coefficient of determination shows that 67 percent of the variability in tax compliance can be explained by tax understanding and taxpayer awareness. This relatively high explanatory power indicates that the model captures the key determinants of compliance behavior, although a portion of the variance remains unexplained, suggesting the presence of additional influencing factors beyond the scope of this study.

Hypothesis Testing

Table 3. Path Coefficients

Relationship	Coefficient	T-Statistic	P-Value	Result
X1 → Y	0.907	5.305	0	Significant
X2 → Y	-0.118	0.575	0.565	Not Significant

The hypothesis testing results provide strong evidence that tax understanding significantly influences tax compliance. The high coefficient value indicates a strong positive relationship, suggesting that improvements in tax knowledge substantially enhance the likelihood of compliant behavior. This finding reinforces the argument that in a self-assessment system, the ability to understand and apply tax regulations is a critical determinant of compliance.

In contrast, taxpayer awareness does not exhibit a significant relationship with compliance. The negative coefficient, although not statistically significant, suggests that awareness alone may not be sufficient to encourage compliance and may even reflect cognitive dissonance among taxpayers who understand their obligations but lack the capability or motivation to act accordingly.

Effect Size Analysis

Table 4. Effect Size (f^2)

Relationship	f^2	Effect
X1 → Y	0.74	Large
X2 → Y	0.02	Small

The effect size analysis provides additional insight into the relative importance of each variable in the model. Tax understanding demonstrates a large effect size, confirming its dominant role in explaining compliance behavior. Conversely, taxpayer awareness shows only a negligible effect, further emphasizing its limited contribution in the absence of technical knowledge.

Discussion

The findings of this study highlight the central role of tax understanding as a driving force behind MSME tax compliance. This result is consistent with the theoretical framework of rational behavior, which posits that individuals require sufficient knowledge and capability to perform complex tasks effectively (Ajzen, 1991; Kirchler, 2007). In the context of taxation, the ability to calculate, report, and comply with regulations is fundamentally dependent on technical understanding, particularly within a self-assessment system that places responsibility on taxpayers to independently manage their obligations (Mardiasmo, 2019; Waluyo, 2021). This finding reinforces prior research indicating that higher levels of tax literacy significantly improve voluntary compliance by reducing uncertainty and errors in tax administration (Saad, 2014; Devos, 2014).

The lack of a significant relationship between taxpayer awareness and compliance suggests that awareness alone does not guarantee behavioral change. While taxpayers may recognize the importance of taxes, this recognition does not automatically translate into compliance without the necessary knowledge and skills. This finding aligns with behavioral tax theory, which emphasizes that attitudes and awareness must be supported by perceived behavioral control and actual capability to influence behavior (Ajzen, 1991; Torgler, 2005). Furthermore, previous studies have shown that awareness-based approaches often fail to produce sustainable compliance when taxpayers lack procedural understanding or face administrative complexity (Alm, 2019; Kirchler, 2007). Therefore, this result challenges the effectiveness of awareness-based policies and underscores the need for more practical and education-oriented interventions that enhance both knowledge and skills among taxpayers.

Limitations and Future Work

This study is subject to several limitations, including a relatively small sample size and reliance on self-reported data, which may introduce bias. Future research should consider incorporating additional variables such as tax sanctions, administrative complexity, and technological factors to develop a more comprehensive model of tax compliance behavior.

CONCLUSIONS

This study concludes that tax understanding significantly influences MSME tax compliance, whereas taxpayer awareness does not have a meaningful effect. The model demonstrates substantial explanatory power, indicating that knowledge-based factors are critical determinants of compliance behavior. These findings suggest that policymakers should prioritize enhancing tax literacy through structured education programs and improving the accessibility of tax systems. By focusing on practical knowledge and skill development, it is expected that compliance levels among MSMEs can be further improved, thereby contributing to more effective tax revenue collection.

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