

Exploring the Interplay of Tax Understanding, Compliance Costs, and Tax Compliance among Indonesian MSMEs: A Structural Equation Modeling Approach

Dodik Juliardi^{1*}, Darusalam², Jamaliah Said², Triadi Agung Sudarto¹

¹Universitas Negeri Malang, Indonesia

²Accounting Research Institute, Universiti Teknologi Mara, Malaysia

dodik.juliardi.fe@um.ac.id (Corresponding author)

Abstract. This study examines the impact of tax understanding on tax compliance among Indonesian MSMEs, considering the mediating and moderating role of compliance costs. Drawing on deterrence theory, the research employs structural equation modeling (SEM-PLS) to analyze survey data collected from 500 MSMEs using purposive sampling. The findings reveal a significant direct effect of tax understanding on tax compliance and compliance costs. Moreover, compliance costs are found to mediate the relationship between tax understanding and tax compliance, suggesting that higher tax understanding leads to lower compliance costs, which in turn enhances tax compliance. The study contributes to the literature by providing insights into the complex interplay between tax understanding, compliance costs, and tax compliance in the context of MSMEs in Indonesia. The findings have important implications for policymakers and tax authorities in designing strategies to improve tax compliance among MSMEs.

Keywords: Taxpayers Understanding, cost compliance, Tax compliance, MSMEs

1. Introduction

Over the past five years, there has been a noticeable increase in tax compliance among the populace, particularly in the last three years. In 2021, the annual tax return receipts surpassed expectations, exceeding the goal by up to 80%. Despite this positive trend in tax payments, there remains a significant proportion of Indonesian MSMEs who either fail to fulfill their tax obligations or evade them altogether (Dihni, 2022). This persistent issue underscores the considerable challenge tax authorities continue to face in ensuring taxpayer compliance, particularly within the Indonesian context.

Research into tax compliance often draws upon the deterrence theory (Devos, 2007), which posits that taxpayers are motivated by both moral considerations and a rational assessment of the costs and benefits associated with compliance. This economic deterrence perspective suggests that taxpayers engage in a cost-benefit analysis when deciding whether to comply with tax regulations, emphasizing the importance of addressing the underlying factors influencing compliance behavior.

According to the deterrence theory framework, several factors play a part in specifying tax compliance, including taxpayers' level of understanding, the complexity of tax regulations, and the costs associated with compliance (Musimenta, 2020). Challenges in compliance can stem from issues such as taxpayers' limited awareness of their obligations and the public's unfamiliarity with tax procedures.

While previous research has often explored the direct relationship between taxpayer understanding and compliance, there is a growing need to investigate indirect pathways, including the mediating role of tax compliance costs. Building on insights from studies such as Musimenta's research in Uganda, which revealed a negative impact of tax knowledge on compliance, this study adopts path analysis to examine both direct and moderating effects (Musimenta, 2020). While similar in focus, this research differs in analytical methodology, geographical context, and theoretical framing.

This study's objective was to shed light on the role of tax compliance costs in shaping overall compliance behavior, distinguishing between internal and external compliance costs. Internal costs encompass the time and resources expended by individuals or organizations in fulfilling tax-related obligations, including preparation of documentation and interactions with tax authorities (Loh et al., 1997). In contrast, external costs involve payments made to external entities such as legal or accounting firms for professional services (Loh et al., 1997).

By delving into the complex interplay between taxpayer understanding, compliance costs, and overall compliance behavior, this research seeks to inform strategies aimed at enhancing tax compliance and promoting a culture of fiscal responsibility. Therefore, this study will examine the effect directly of taxpayer understanding on taxpayer compliance and also test indirectly through tax compliance costs.

The cost and benefit theory, pioneered by Drèze and Stern (1987), plays a pivotal role in decision-making processes by facilitating an in-depth evaluation of potential outcomes. This theoretical framework enables companies to assess whether a decision will yield added value (Vessey, 1994). If the analysis reveals that the benefits outweigh the costs, the decision is deemed appropriate (Drèze & Stern, 1987). This theory encompasses a wide array of applications, including the conceptualization of costs and benefits associated with tax avoidance practices (Maisaroh & Setiawan, 2021). Notably, one of the primary benefits of tax avoidance strategies is the manipulation of cash flow.

Taxpayer Understanding, as defined by Rahayu (2020), entails the ability of taxpayers to comprehend, interpret, and foresee the consequences of tax regulations. This encompasses factors such as awareness, socialization, ability, and awareness of tax sanctions. A thorough grasp of tax knowledge empowers taxpayers to navigate complex tax landscapes effectively.

Tax Compliance Costs encompass the resources expended by corporate taxpayers to adhere to tax regulations, encompassing tasks such as completing tax returns, maintaining records, and acquiring necessary knowledge. These costs can be categorized into internal and external compliance costs. Internal compliance costs stem from expenses incurred within the company, including stationery, seminars, and software maintenance. External compliance costs, on the other hand, arise from payments for services rendered by external entities such as lawyers, investment advisors, and public accountants

(Loh et al., 1997).

Tax Compliance refers to taxpayers' adherence to applicable tax provisions, as outlined by Rahayu (2020). This entails the submission and compliance with tax laws and regulations. Compliance can be further delineated into formal and material tax compliance. Formal tax compliance entails timely registration for tax identification numbers, prompt payment of taxes, and accurate reporting of tax liabilities. Material tax compliance, on the other hand, pertains to adherence to substantive tax provisions, including accurate calculation of tax liabilities and adherence to tax deduction requirements. These provisions are mandatory for fulfilling tax obligations effectively.

1.1. Taxpayers Understanding and Tax Compliance

Tax understanding encompasses the taxpayer's proficiency in defining, formulating, and interpreting tax regulations, along with the ability to discern the implications of this comprehension. In Indonesia, the prevailing tax collection system operates on the principle of self-assessment, entrusting taxpayers with the responsibility to independently calculate, pay, and report their taxes. Therefore, the success of this system hinges on taxpayers' comprehension and adherence to procedural requirements. According to deterrence theory, a taxpayer's comprehension of tax laws correlates with compliance, particularly in terms of accurately calculating, paying, and reporting taxes promptly. Moreover, taxpayers are presumed to grasp the legal ramifications of non-compliance, including awareness of potential sanctions and fines (Adhikari 2020; Hardika, Askara, and Wijana 2022; Ridhotin and Ardini 2022). Taxpayer compliance is a condition or time when taxpayers can fulfill their tax obligations and exercise their taxation rights. Devano & Rahayu (2006) revealed that taxpayer compliance is influenced by several factors, namely the condition of a country's tax administration system, services to taxpayers, tax law enforcement, tax audits, and tax rates. Febriani & Kusmuriyanto (2015) suggest that the factors that cause low taxpayer compliance are: (1) public dissatisfaction with public services; (2) uneven infrastructure development; and (3) many cases of corruption committed by the government. Gunarso (2016) proved empirically that tax audits and sanctions can affect tax compliance. Muslichah (2015) successfully proved the effect of tax simplicity on tax compliance behavior. Mangoting & Sadjiarto (2013) confirmed that motivation using motivational posture indicators in the form of game-playing variables partially affects individual taxpayer compliance in implementing tax compliance. Yee, Moorthy, & Choo (2017) found a positive effect of tax justice on taxpayer compliance. One of the factors that influence the level of taxpayer compliance is the level of understanding of taxation. Taxpayer understanding of tax regulations is how taxpayers understand existing regulations. The lack of understanding of taxpayers of tax regulations causes taxpayers to be unable to fulfill their obligations so they become non-compliant taxpayers (Hardiningsih & Yulianawati, 2011). Several researchers have proven that tax understanding can positively and significantly affect taxpayer compliance (Adiasa, 2013; Saad, 2014; Ananda, 2015; Andinata, 2015; Andreas & Savitri, 2015; Nurhayati, Halimatusadiah, & Diamonalisa, 2015; Agustiningsih & Isroah, 2016; Ilhamsyah, Endang, & Dewantara, 2016; Nugroho, Andini, & Raharjo, 2016; Oladipupo & Obazee, 2016; Redae & Sekhon, 2016; Olaoye, Ayeni-Agbaje, & Alaran-Ajewole, 2017). Meanwhile, Andinata (2015) found a different perspective, understanding tax regulations does not have a significant effect on taxpayer personal compliance. Saad (2014) states that a lack of understanding of taxation can lead to taxpayer non-compliance behavior. Agustiningsih & Isroah (2016) stated that taxpayer compliance can be measured through how much the taxpayer understands all applicable tax laws and regulations, and how taxpayers can carry out tax submission procedures correctly. Then, they prove that the level of understanding of taxation has a positive and significant effect on taxpayer compliance. Yee, Moorthy, & Choo (2017) state that tax understanding is an important factor that can influence taxpayer compliance behavior. Taxpayer compliance is also influenced by taxpayer awareness. Taxpayer self-awareness is needed because the applicable collection system is self-assessment which provides full opportunities for taxpayers to complete their tax obligations. Suryarini & Tarmudji (2009) emphasize that taxpayers with their awareness should pay taxes correctly (all reported income). But in reality, everyone tends to avoid paying taxes. Many studies

have proven a positive and significant influence between taxpayer awareness and taxpayer compliance (Palil, Rusyidi, & Ahmad, 2013; Andinata, 2015; Andreas & Savitri, 2015; Fajriyan, Endang N.P., & Prasetya, 2015; Agustiningsih & Isroah, 2016; Ilhamsyah, Endang, & Dewantara, 2016; Savitri & Musfialdy, 2016). Meanwhile, Nugroho, Andini, & Raharjo (2016) underline that awareness has no partial effect on tax compliance.

Consequently, taxpayers are incentivized to adhere to tax regulations to avoid detection and prosecution by tax authorities. Drawing from theoretical frameworks and prior research findings, the following hypotheses can be formulated as follow :

H1: Taxpayers Understanding positively influence on Tax Compliance.

1.2. Taxpayer Understanding and Compliance Costs

This variable is the taxpayer's proficiency in defining, formulating, and construing tax law, such as the ability to know the result and purpose that will occur because of the understanding they have (Rahayu, 2020). Based on Deterrence theory (Devos, 2007). If the taxpayer has the proficiency to interpret tax law, it implies that the taxpayer can be able to analyze it thoroughly to broaden his view of taxation. Based on deterrence theory, taxpayers will analyze considering the costs and benefits, because taxpayers' understanding increases, causing compliance costs to decline, thus not relying again Relief assistance from third parties.

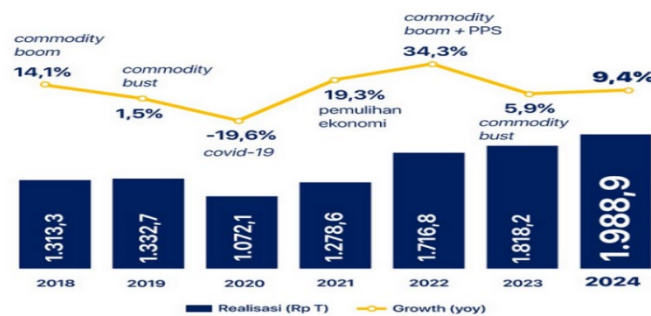


Fig.1: Graphic Increase in SMEs Tax Compliance in Indonesia

Furthermore, what affects taxpayer compliance is tax socialization, so far tax socialization. According to Andreas and Savitri (2015) tax socialization is steam tax socialization is an effort of the Directorate General of Taxes to provide understanding and information to taxpayers to achieve its goals. Tax socialization is less applied to provide direction/guidance to taxpayers, especially since there have a tax incentives from the government recently, because not all taxpayers understand PMK No. 86 of 2020, the socialization has only been done through news. For example: Finance Minister Sri Mulyani issued tax incentives regarding, and also at the DGT / tax officials only conducts collection at tax offices and services at tax offices without any socialization. services at KPP without any socialization. Moreover, since the COVID-19 pandemic, all activities have mostly switched to virtual/online, so it does not rule out the possibility for tax officials to conduct online socialization. A lack of understanding about tax leads to a lack of compliance from taxpayers. A lack of understanding can result in taxpayers not complying with their obligation to pay taxes. Compliance is a program made by the Directorate General of Taxes at any time, and taxpayers are expected to realize how important the role of taxes and their role is for a country. According to Ilhamsyah et al (2016) what is meant by taxpayer compliance is the ability of taxpayers to fulfill tax obligations exercise their taxation rights fairly and follow applicable tax laws and regulations.

From this explanation, it can be concluded that taxpayer compliance is the ability of taxpayers to carry out their obligations as taxpayers by following applicable laws and regulations, namely obtaining NPWP, conducting self-assessment (calculating, collecting, paying, and reporting taxes), checking and providing data. Rachmawati and Ramayanti (2016) say that "Tax incentives are tax policies provided

by the government to certain taxpayers, to increase investor interest in making investments". According to Ayu (2020), tax incentives are tax policies provided by the state to certain taxpayers, individuals, or entities that support the government, and are used to provide incentives and accommodation to taxpayers so that they always fulfill their tax obligations by following the rules both now and in the future. From this explanation, it can be concluded that tax incentives are government policies for taxpayers to help economic recovery so that taxpayers remain compliant in reporting their taxes for both individuals and entities that support the government. Providing tax incentives is expected to increase taxpayer compliance, both individual and corporate taxpayers, in carrying out their tax obligations, both in terms of reporting and paying taxpayers. Sitorus' research (2020) on the impact of tax incentives on taxpayer compliance, shows that the results of tax incentives have a positive and significant effect on taxpayer compliance. During the COVID-19 pandemic. On the other hand, Dewi et al (2020) found that tax incentives did not have a significant effect on taxpayer compliance during the Covid-19 pandemic. Of course, the effect of tax incentives on compliance needs to be retested, considering that both studies were conducted during the COVID-19 pandemic and with the same topic of discussion. the same topic of discussion. Based on theory and study before can be formulated hypothesis as follows:

H2: Taxpayers understanding positively influence on Compliance Costs.

1.3. Taxpayers Understanding and Tax Compliance by the Mediation of Compliance Costs

Compliance costs are all expenses related to the goal of complying with industry regulations. According to Loh *et al.*, 1997, these costs came externally from the paid to lawyers, accountants, and investment consultants for their services. The deterrence theory states that if a taxpayer intends to comply with tax regulations, he or she must analyze the cost benefits. Taxpayers consider the costs they will incur with the benefits they will obtain (Alsughayer 2021). taxing and have a distortionary impact on the development of small and medium-scale enterprises as they are tempted to change into forms that offer a lower tax burden or no tax burden at all. Tax laws are too complicated for taxpayers to keep up to date considering the frequent changes in the tax law (Loo et al., 2010) and that's why some corporate taxpayers deploy services of external tax professionals when they experience difficulties in tax issues (Sapiei & Kasipillai, 2013). Therefore, the complexity of the tax system consequently and usually results in unintentional noncompliance.

This is because some taxpayers may find it hard to source the services of external tax professionals given that it is not a free service. The researcher can, therefore, hypothesize that: H2a: There is a relationship between tax complexity and compliance costs: There is a relationship between tax complexity and tax compliance H2c: compliance costs mediate the relationship between complexity and tax compliance

2.4. Compliance costs and tax compliance

Compliance costs are costs incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given structure and the level of tax (Eichfelder & Schorn, 2012). From the literature, Eichfelder and Schorn (2012) analyzed three reasons why compliance costs can be considered a major economic problem. First, they reduce the resources of private businesses without raising the financial budget of the government. Thus, they are an economic waste. Second, the economic burden of tax compliance decreases with growing business size and rises with the international orientation of businesses. These effects could reduce the competitiveness of small and medium-sized enterprises and reduce their access to international markets. Thirdly, Tax compliance costs seem to be linked to the compliance level. Hence, they could lead to tax evasion. Maseko (2014) found that taxpayers prefer tax bribes to reporting all their tax affairs implying that compliance costs influenced them to avoid tax compliance. Tax compliance costs include internal costs and external costs. Internal costs arise from the time costs of internal staff spent on maintaining and preparing information for professional advisers, completing tax forms, and dealing with tax authorities on matters about inquiries, objections, and appeals (Loh et al., 1997). External costs arise from payments to acquire the services of lawyers, accountants, and investment advisers from outside the company (Loh et al., 1997). External costs are more easily

recognizable and quantifiable compared to internal costs. Internal costs are difficult to quantify as their estimation requires fairly subjective apportionment of joint overhead and other costs. External costs, mainly in the form of advisors costs, using professional tax service providers is one of the main costs contributing to the cost of complying with taxation legislation (Coolidge et al., 2009). If these costs are in line with tax compliance then taxpayers will incur these costs, conversely, if they are not in line with compliance objectives then taxpayers will violate them and tend to pay sanctions and fines. Thus, based on theory and study before can be formulated hypothesis as follows:

H3: Compliance Costs mediate between Taxpayers Understanding and Tax Compliance

2. Research Methods

Quantitative research methods are the approach in this research. Based on the hypothesis that has been formulated, this research tested the influence of taxpayer understanding on tax compliance immediately or explicitly, mediated by compliance costs as a mediating variable. This study employs a quantitative technique within the realm of survey research. A questionnaire was utilized to collect data from 200 MSMEs in Jakarta. The sample approach employed was non-probability using convenience sampling. The data analysis method uses Structural Equation Modeling-Partial Least Squares (SEM-PLS) to assess both the outer and inner models for testing the measurement tools and research hypotheses. Utilizing SMART-PLS3.3.3 software for data processing and analysis research model to be tested is described as follows:

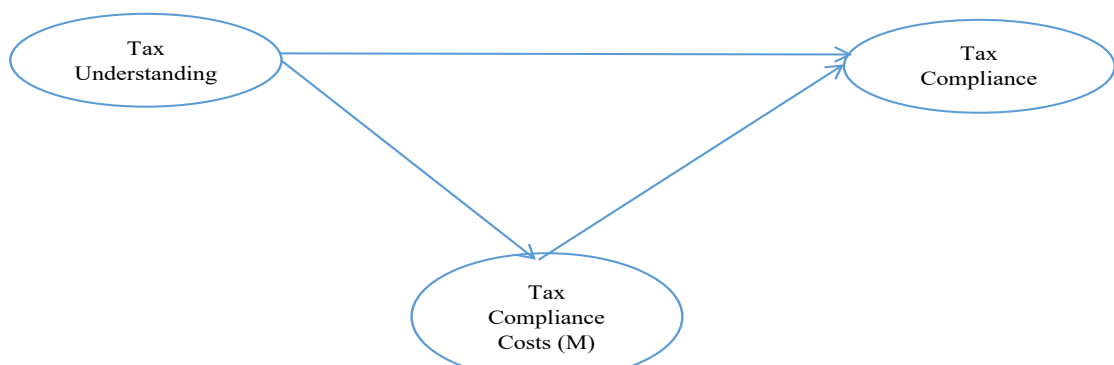


Fig.2: Research Model

2.1. Operational Definition

Taxpayer Compliance is defined as the level of compliance of a taxpayer following tax law (Rahayu, 2020). In this study, it was weighed against 4 indicators. The first indicators are (1) Reporting the Tax Return On time, (2) No tax arrears, (3) Financial reports have been audited by accountants and consultants, and (4) no criminal action has been taken for ten years. This variable is measured on a 1-5 Likert scale.

Table 1. Research instrument answer scores.

Statement	Score
Strongly Disagree	1
Don't agree	2
Neutral	3
Agree	4
Strongly agree	5

Taxpayer understanding is the ability to define, formulate, and interpret tax regulations, in addition to the ability to view the outcome or meaning of the likelihood that arises in understanding (Rahayu, 2020). This variable was weighed against by five indicators, which consist of insight, mindfulness, dissemination, competence, and tax sanctions. A 1-5 Likert scale is used to measure this variable as shown at the table Table 1.

Tax compliance costs are the costs incurred by the taxpayers in meeting the conditions set by the tax regime. According to Eichfelder & Schorn (2012), these costs are incurred by taxpayers, or business-oriented third parties. Tax obedience is classified into 2 kinds, consisting of internal and external compliance costs. Tax Obedience cost is incurred when staff spends their time providing and preparing information for professional advice, preparing fiscal tax reports, and dealing with tax fiscus about inquiries, objections, and appeals. (Loh et al., 1997). Internal compliance costs, namely taxes are always handled internally, handled routinely, there is tax planning, etc. While internal compliance costs are aimed at paying external parties measured by 4 indicators. To measure these costs such as lawyers' fees, public accountant fees, tax consultant fees, and investment consultant fees

2.2. Population and Sample

MSMEs are the population in this study registered in the Investment and Manpower office of Mojokerto City, East Java province. There are 500 populations of MSMEs. The taxpayers studied are taxpayers who were classified as MSMEs with an average income yearly with a range of up to 10 million Rupiah to 1 billion Rupiah. The purposive sampling method was used and obtained 30 MSMEs. The criteria are as follows :

Table 2. Summary of important points in sampling

No	Sample Criteria	Number of MSMEs
1	Population MSMEs are listed in tthe Investment and Manpower office of Mojokerto City.	500
1	MSMEs with unclear addresses and telephone/cellphone numbers	208
2	MSMEs have gone bankrupt and shifted business and this is not recorded	242
3	MSMEs which did not return the questionnaire	20
4	Number of MSMEs who filled out the questionnaire	30

Primary data is the type of data in this research gathered from the Investment and Manpower office of Mojokerto City workforce. Structural Equation Modelling Partial Least Square analysis (SEM PLS) is used to test hypotheses that have been formulated to test the direct or indirect effects. The aim is to determine the direct effect of tax understanding on tax compliance and the indirect effect of tax understanding on tax compliance through the moderation and mediation of the tax compliance cost variable.

SmartPLS is a statistical data analysis program that can be used to test directly or indirectly. If used to test indirect variables, the application of this statistical data is also known as SEMPLS (Structural Equation Modeling Partial Least Square) which can be used to test either moderating or mediating variables, so it can also find out whether a variable acts as a moderating variable. or mediating variables. Therefore, in this research, we will test the compliance cost variable as a moderating variable or

mediating variable.

3. Data Analysis and Results

The first step is to test whether the compliance cost variable is a moderating variable, it will be seen from the analysis results in Table 3 below.

Table 3. Hypothesis Testing on Moderating Variable

Final Results

Path Coefficients

Mean, STDEV, T-Values, P-Values

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/ST DEV)	P Values
X1-Tax Understanding -> Y1-Taxpayers Compliance	0.560	0.564	0.094	5.941	0.000
X1-Tax Understanding -> Z1-Cost Compliance -> Taxpayers Compliance	0.071	0.049	0.058	1.226	0.221
Z1-Cost Compliance -> Y1-Tax Payers Compliance	0.426	0.431	0.090	4.738	0.000

Specific Indirect Effects

After testing, the results obtained show that for the direct influence between tax understanding and tax compliance there is an essential influence. Likewise for tax compliance costs to tax compliance. This can be seen from the results of each p-value <0.05. However, it is different for the indirect effect, if compliance costs are connected as a moderating variable, the results are not significant (P-value>0,05), which means that this variable does not play a moderating role. Thus, the next test is to find out whether Compliance Costs act as a mediating variable. The analysis was carried out using the same statistical tools as the test results in the table as follows.

Table 4. Hypothesis Testing on Mediation Variable

Mean, STDEV, T-Values, P-Values

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/ST DEV)	P Values
X1-Tax Understanding -> Y1-Taxpayers Compliance	0,606	0,597	0,099	6.140	0.000
X1-Tax Understanding -> Z1-Cost Compliance -> Taxpayers Compliance	0.272	0.290	0.083	3.276	0.001
Z1-Cost Compliance -> Y1-Tax Payers Compliance	0.392	0.396	0.098	4.019	0.000

Based on Table 4 above it can produce two Equation as follows:

Equation 1: Tax Understanding Variable (X) on Tax Compliance by Mediation of Cost Compliance (Z)

$$Y=0.606X+0,272Z.....(\text{Equation 1})$$

$$Y=0.606X+0,272Z.....(\text{Equation 1})$$

3.1. Hypothesis Testing

Table 5. Regression Analysis

Model	Beta Coefficient		t	Sig.
1	Tax Understanding	0.606	6,140	0,000
	Compliance Cost	0,272	3,276	0,001

Y = Tax Compliance

Table 5 lists the regression of the first model with a coefficient of 0,606 between tax understanding and tax compliance directly. This coefficient indicates that there is a directional relationship between the two variables and the t-statistic p-value of 0.000, which means there is a significant influence between the two variables. Whereas the indirect connection between tax understanding and tax compliance by the compliance cost. The coefficient is 0,272 which is the mean of a positive indirection relationship between the two variables and t statistic p-value of 0.001. These results indicate that tax understanding significantly influences tax compliance mediated by compliance cost, which means that the compliance cost variable could mediate the indirect correlations between tax understanding and tax compliance.

Equation 2: Tax Understanding Variable (X) on Compliance Cost

$$Z= 0,392X(\text{Equation 2})$$

Table 6. Regression Analysis

Model	Coefficient		t	Sig.
2	Tax Understanding	0.392	4,019	0.000

Z= Compliance Costs

Table 6 lists the regression of the second model with a coefficient of 0,392 between compliance cost and Tax compliance. The coefficient 0,392 of tax understanding on Tax compliance cost means that the Tax understanding variable is in the same direction as compliance cost with the p-value of 0.000, which means that the tax understanding variable positively significantly influences the compliance cost

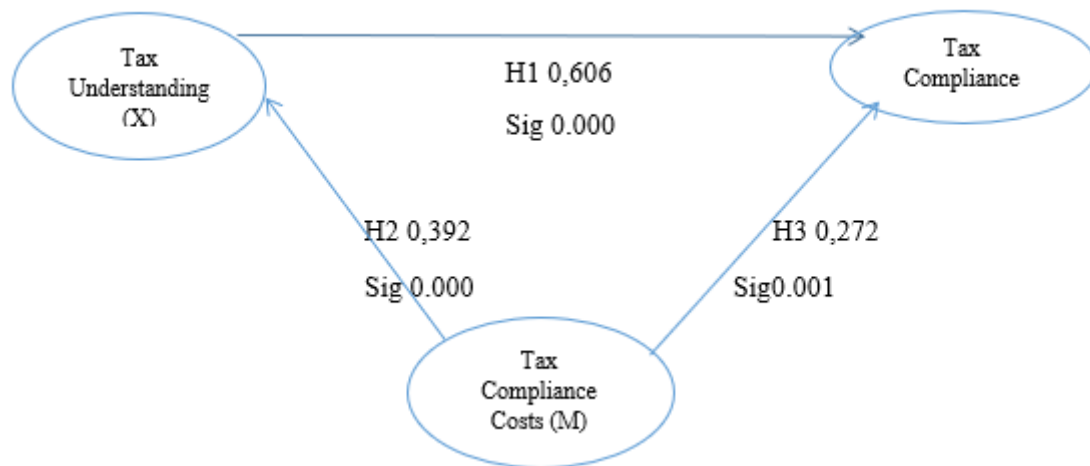


Fig.3: Direct influence of variable X on variable Y and indirect influence through the mediating variable M

4. Discussion

4.1. Taxpayers Understanding and Tax Compliance

Testing hypothesis 1 produces the answer that taxpayers' understanding significantly influence on tax compliance. These results are proven by the results in Table 5 with a coefficient of 0.606 which shows that the two variables are in the same direction with a significant value is 0,000, which reveals that taxpayers' understanding significantly influences Tax Obedience, then the first hypothesis is not rejected. This study supports previous researchers which reveal Tax payer's understanding of taxes was necessary for tax Obedience (Palil, 2010; Machogu and Amayi, 2013; Andriani and Herianti, 2015. Ananda, Kumadji and Husaini, 2015). According to Nugraheni and Purwanto, 2015, Tiraada stated that there is a small amount of variation in taxpayer compliance on involvement with difficult taxpayer payments, but the main factor is the lack of knowledge and understanding of the tax itself. As stated by (Nurkhin et al. 2018; Triandani and Apollo 2020; Yayuk et al. 2017)), every taxpayer must know and understand the rules that apply to the practice of law, so that taxpayers can fulfill their obligations to the law by complying with it with accuracy and integrity. Previously, this research was conducted by (Riduwan, Diana, and Afifudin 2021) with the results of a study entitled “The Effect of Understanding Taxation, Tax Sanctions and Strictness of Tax Sanctions on Taxpayer Compliance in MSMEs in Indonesia, in Indonesia” by showing a significant and positive impact in understanding taxpayers on MSME tax compliance. Where knowing the understanding that affects tax costs such as tax payments creates benefits for developing Indonesia so that it is obedient in paying taxes.

Tax understanding is the extent to which taxpayers master and know the tax collection system that applies in Indonesia with its various tax regulations. The SAS (self-assessment system) is a tax collection system that applies in Indonesia where taxpayers have full trust to calculate, pay, and report the amount of tax owed. Prevention theory is the theoretical basis that supports the results of this study, that when taxpayers comprehend tax rules in other words taxpayers obey if they know how to countings, deposit, and report taxes before the deadline. Such taxpayers are taxpayers who understand the legal consequences including penalties and charges that they will bear, therefore taxpayers choose not to obey the regulations or laws so as not to be caught or even subject to legal sanctions by officials (Obaid, Gurama, and Ibrahim, 2022). This result is supported by items from the results obtained in the questionnaire that sanctions get the highest average in the taxpayer understanding item. This regulation will make taxpayers more disciplined in their tax obligations. To design interventions or educational

programs targeted at improving tax and MSME understanding, tax authorities can use insights from the study in the following ways: **Identify Key Challenges:** Analyze the study to identify the key challenges MSMEs face related to tax understanding. These may include a lack of knowledge of tax obligations, difficulties in tax administration compliance, or inability to take advantage of available tax incentives. **Audience Segmentation:** Understand the different types of MSMEs and their needs and characteristics. This allows tax authorities to craft education programs that suit the specific needs of each MSME segment.

Development of Educational Materials: Based on the study findings, tax authorities can develop educational materials that are relevant and easy to understand. These can include step-by-step guides on tax obligations, explanations of tax incentives that can be utilized, and resources to help MSMEs understand and fulfill their tax obligations. **Use of Relevant Media:** Select the most effective medium to deliver information to MSMEs. This could be in-person workshops, online webinars, printed materials, or digital platforms specifically designed to provide tax-related information and support to MSMEs. **Collaboration with Related Parties:** Engage relevant parties such as MSME associations, tax consultants, or educational institutions to support the delivery of educational programs. Such collaboration can increase the reach and effectiveness of the program. **Evaluation and Adjustment:** Establish metrics to evaluate the success of the program and make adjustments based on feedback from MSMEs. This allows tax authorities to continuously improve and adjust their education programs to suit the needs and preferences of MSMEs. Using the insights from this study and applying the steps above, tax authorities can design effective interventions or education programs to improve tax understanding and support for MSMEs.

4.2. Direct Taxes Understanding on Compliance Costs

Hypothesis H2 confirms that there is an impact on taxpayers' understanding and compliance costs of the MSMEs analyzed. This finding is proven by the results of regressing tax understanding and tax compliance costs with a coefficient of 0.392, which means the two variables are in the same direction, and a t-statistic value or P-value of 0.000, which means they have a significant effect. Then the second hypothesis is not rejected.

The results of this study reconfirm what has been found in previous research that the majority of MSMEs prefer to handle matters related to tax obligations themselves, however, this is because MSMEs on average do not have adequate skills. Abrie and Doussy (2006). Thus, to overcome matters related to compliance issues, many MSMEs ask for help from external parties by incurring additional costs to be able to handle matters related to tax calculations. (Barrios, d'Andria, and Gesualdo 2020; Morikawa 2023; Musimenta 2020)

4.3. The Indirect Tax Taxpayers' understanding of Tax Compliance by Mediation of compliance Costs.

Hypothesis 3

Hypothesis H3 confirms that compliance costs can mediate the impact of tax understanding and tax compliance. Thus Testing of Hypothesis 3 is proven by the results of regressing tax understanding and tax compliance by the mediation of compliance costs with coefficients is 0,272 which means the two variables are in the same direction and the t-statistic value or P-value is 0.001 which means it has a significant effect. Then the third hypothesis is not rejected.

Several previous studies from Obaid, Gurama, and Ibrahim, 2022; and Sapiei & Abdullah, 2014 support the results of this research that compliance behavior was mediated by tax compliance costs. Meanwhile opposite by Abdul-Jabbar (2009) and that reducing tax compliance costs might increase voluntary tax compliance (Mahangila, 2017)

5. Conclusion

This study provides valuable insights into the factors influencing tax compliance among Indonesian

MSMEs, highlighting the crucial role of tax understanding and compliance costs. The findings suggest that enhancing tax understanding can directly improve tax compliance and indirectly by reducing compliance costs. The mediating effect of compliance costs underscores the importance of simplifying tax procedures and providing support to MSMEs to minimize the burden of compliance. The study contributes to the literature by offering empirical evidence on the complex relationships between tax understanding, compliance costs, and tax compliance in the context of MSMEs in a developing country. The findings have significant implications for policymakers and tax authorities in designing strategies to foster voluntary tax compliance and create a more conducive environment for MSMEs to fulfill their tax obligations. Future research could explore the effectiveness of specific interventions aimed at improving tax understanding and reducing compliance costs, as well as investigate the role of other factors, such as tax morale and perceived fairness, in shaping tax compliance behavior among MSMEs.

Aknowledgment

We wish to express our gratitude to the WCU EQUITY UM (University of Malang) for their support and funding.

Reference

- Adhikari, Naba Raj. 2020. "Taxpayer Awareness and Understanding on Taxpayer Compliance in Nepal." *Management Dynamics* 23(1). doi: 10.3126/md.v23i1.35574.
- Alsughayer, Sulaiman A. 2021. "VAT Compliance Challenges Among SMEs: Evidence from Saudi Arabia." *Journal of Accounting Finance and Auditing Studies (JAFAS)* 7(3). doi: 10.32602/jafas.2021.018.
- Baron Reuben M, and Kenny David A. 1986. The Moderator-Mediator Variable distinction in Social Psychological Research: Conceptual, strategic, and statistical Consideration. *Journal of personality and Social Psychology*, Volume 51, No. 6. 1173-1182
- Barrios, Salvador, Diego d'Andria, and Maria Gesualdo. 2020. "Reducing Tax Compliance Costs through Corporate Tax Base Harmonization in the European Union." *Journal of International Accounting, Auditing and Taxation* 41. doi: 10.1016/j.intaccudtax.2020.100355.
- Devos, K. (2007). Measuring and analyzing deterrence in taxpayer compliance research. *Journal of Australian Taxation*, 10(2), 182–219.
- Dre'ze, Jean, and Nicholas Stern. 1987, The theory of cost-benefit analysis. Jean Dreze and Nicholas Stern. Chapter 14 in *Handbook of Public Economics*, 1987, vol. 2, pp 909-989
- Eichfelder, S., & Schorn, M. (2012). Tax compliance costs: A business-administration perspective. *FinanzArchiv/Public Finance Analysis*, 68(2), 191–230. <https://doi.org/10.1628/001522112X639981>
- Hardika, Nyoman Sentosa, I. Kadek Jesta Askara, and I. Made Wijana. 2022. "THE EFFECT OF TAXPAYER UNDERSTANDING AND USE OF E-FILING ON TAXPAYER COMPLIANCE WITH TAX VOLUNTEER AS MODERATING VARIABLE." *JURNAL INFORMASI, PERPAJAKAN, AKUNTANSI, DAN KEUANGAN PUBLIK* 17(1). doi: 10.25105/jipak.v17i1.10147.
- Kumadji, Heroine; Ananda, Post Rizky Dwi; and Husaini, Ahmad (2015), The Influence of Tax Socialization, Tax Rates, and Tax Understanding on Taxpayer Compliance (Study of MSMEs Registered as Taxpayers at the Batu Pratama Tax Service Office) *Journal of Taxation (JEJAK)* Vol. 6 No. 2 Pages 1-9|
- Loh, A., Ariff, M., Ismail, Z., Shamsher, M., & Ali, M. (1997). Compliance costs of corporate income

taxation in Malaysia. *Pacific Accounting Review*, 9(1), 27–42.

Machogu, C.G., & Amayi, J.B. 2013. The Effect of taxpayer education on voluntary Tax Compliance among SMEs in Mwanza City Tanzania, *International Journal of Marketing, Financial Services & Management Research*, 2(8), 12-13,

Maisaroh & Setiawan, 2021. Foreign Shares Ownership, Foreign Board of Commissioners and Foreign Board of Directors on Tax Avoidance in Indonesia, *Journal of Accounting and Business*, Vol. 21 No. 1, Februari 2021: 29-42

Morikawa, Masayuki. 2023. “Compliance Costs and Productivity: An Approach from Working Hours.” *Journal of Regulatory Economics* 63(3). doi: 10.1007/s11149-023-09460-3.

Musimenta, Doreen. 2020. “Knowledge Requirements, Tax Complexity, Compliance Costs and Tax Compliance in Uganda.” *Cogent Business and Management* 7(1). doi: 10.1080/23311975.2020.1812220.

Musimenta, Doreen., 2020 Knowledge Requirements, tax complexity, Compliance costs and Tax Compliance Costs in Uganda

Nurkhin, Ahmad, Ine Novanty, Muhsin Muhsin, and Sumiadji Sumiadji. 2018. “The Influence of Tax Understanding, Tax Awareness and Tax Amnesty toward Taxpayer Compliance.” *Jurnal Keuangan Dan Perbankan* 22(2). doi: 10.26905/jkdp.v22i2.1678.

Obaid, Muhammad Mahdi, Gurama, Sakariya U and Ibrahim, Idawati, 2022. Perception on Tax System Structure, Tax Compliance Costs and Tax Compliance Behavior in Yemen, *International Journal of Business and Technopreneurship* Volume 12, No 3, October 2022 [57- 72]

Palil, MR (2010): Tax Knowledge and tax compliance determinants in self-assessment system in Malaysia, PhD Thesis, The University of Birmingham

Rahayu, SK (2020). Taxation Concept, System and Implementation. Bandung: Science Engineering.

Ridhotin, Nabilla Fatma, and Lilis Ardini. 2022. “Pengaruh Pemahaman Perpajakan, Sanksi Perpajakan, Kemudahan Pajak Terhadap Kepatuhan Wajib Pajak UMKM.” *Jurnal Ilmu Dan Riset Akuntansi (JIRA)* 11(9).

Riduwani, Muhamad Erdin, Nur Diana, and Afifudin. 2021. “Pengaruh Tingkat Pemahaman, Kepatuhan DAN Ketegasan Sanksi Perpajakan Terhadap Kewajiban Perpajakan UMKM Di Kota Malang.” *E-Jra* 10(06).

Triandani, Megi, and Apollo Apollo. 2020. “EFFECT THE UNDERSTANDING OF TAXATION, TAX SANCTIONS AND TAXPAYER AWARENESS OF TAXPAYER COMPLIANCE (RESEARCH ON TAXPAYERS OF INDIVIDUAL ENTREPRENEURS IN TANGERANG REGION).” *Dinasti International Journal of Digital Business Management* 2(1). doi: 10.31933/dijdbm.v2i1.638.

Yayuk, Ngesti Rahayu, Setiawan Margono, Afnan Troena Eka, and Sudjatno. 2017. “The Role of Taxpayer Awareness, Tax Regulation and Understanding in Taxpayer Compliance.” *Journal of Accounting and Taxation* 9(10). doi: 10.5897/jat2017.0267. Abdul-Jabbar, H. (2009). Income tax non-compliance of small and medium enterprises in Malaysia: Determinants and tax compliance costs. Unpublished doctoral dissertation, Curtin University of Technology, Perth, Australia.