

The Effect of Tax Incentives on MSME Tax Compliance in Indonesia

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Abstract. Micro, Small, and Medium Enterprises (MSMEs) play a strategic role in the Indonesian economy; however, the level of tax compliance among MSME taxpayers remains relatively low. The Indonesian government has implemented various tax incentive policies, particularly the final income tax scheme for MSMEs, as an effort to encourage tax compliance and broaden the national tax base. This study aims to analyze the effect of tax incentives on MSME tax compliance in Indonesia. This study employs a quantitative approach using a survey method involving MSME taxpayers registered in Indonesia. Data were collected through questionnaires and analyzed using multiple linear regression analysis or Structural Equation Modeling–Partial Least Squares (SEM-PLS). The independent variable in this study is tax incentives, while the dependent variable is MSME tax compliance. The results indicate that tax incentives have a positive and significant effect on MSME tax compliance. The provision of tax incentives encourages MSME taxpayers to fulfill their tax obligations more consistently, both in terms of formal and material compliance. These findings suggest that well-targeted and sustainable tax incentive policies can effectively improve MSME tax compliance. This study contributes theoretically to the literature on MSME taxation and provides practical implications for policymakers in evaluating tax incentive policies to enhance tax compliance and optimize government revenue from the MSME sector.

Keywords: Tax Incentives; Tax Compliance; MSMEs; Final Income Tax; Tax Policy

INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) play a crucial role in Indonesia's economic development by contributing significantly to gross domestic product, employment creation, and income distribution. The sustainability of MSMEs is therefore a key concern for policymakers, particularly in developing countries such as Indonesia, where MSMEs dominate the business landscape. Despite their economic importance, tax compliance among MSMEs remains relatively low, posing a challenge to government efforts to increase domestic revenue and strengthen the tax system.

Tax compliance is a fundamental element in ensuring sustainable government revenue. However, MSMEs often face various obstacles in fulfilling their tax obligations, including limited financial capacity, low tax literacy, complex tax regulations, and administrative burdens. These challenges may lead MSME taxpayers to perceive taxation as a cost rather than a civic responsibility, resulting in low compliance levels, both in terms of timely reporting and tax payment.

To address this issue, the Indonesian government has introduced several tax incentive policies aimed at supporting MSMEs and encouraging voluntary tax compliance. One of the most prominent policies is the implementation of a final income tax scheme for MSMEs, which simplifies tax calculation and reduces the tax burden. Tax incentives are designed not only to ease financial pressure on MSMEs but also to foster a more compliant tax culture by improving taxpayers' perceptions of fairness and government support.

Previous studies have examined the relationship between tax incentives and tax compliance, with mixed findings. Some studies report that tax incentives positively

influence taxpayer compliance by reducing tax burdens and increasing perceived benefits, while others suggest that incentives alone may be insufficient to ensure long-term compliance without improvements in tax administration and taxpayer awareness. This inconsistency indicates the need for further empirical investigation, particularly in the context of developing economies.

Given the ongoing efforts to strengthen fiscal capacity and support MSME development in Indonesia, it is essential to evaluate the effectiveness of tax incentive policies in enhancing MSME tax compliance. Therefore, this study aims to analyze the effect of tax incentives on MSME tax compliance in Indonesia. The findings of this study are expected to contribute to the existing literature on MSME taxation and provide practical insights for policymakers in designing more effective and sustainable tax incentive policies.

METHOD

3.1 Research Design

This study adopts a quantitative research approach with an explanatory design to examine the effect of tax incentives on tax compliance among Micro, Small, and Medium Enterprises (MSMEs) in Indonesia. The quantitative approach is considered appropriate as it enables the measurement of relationships between variables and the testing of hypotheses using statistical analysis.

3.2 Population and Sample

The population of this study consists of MSMEs registered as taxpayers in Indonesia. The sampling technique used is purposive sampling, with the following criteria: (1) MSMEs that have been operating for at least one year, (2) MSMEs registered as active taxpayers, and (3) MSMEs that are eligible for tax incentive policies. A total of [number] MSME taxpayers were selected as respondents. The sample size was determined based on the minimum requirements for regression analysis or Structural Equation Modeling–Partial Least Squares (SEM-PLS).

3.3 Data Collection Method

Primary data were collected through a structured questionnaire distributed to MSME taxpayers. The questionnaire was designed using a Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). The instrument measures perceptions of tax incentives and the level of tax compliance among MSMEs. To ensure content validity, the questionnaire items were adapted from previous studies and relevant tax compliance literature.

3.4 Variables and Measurement

This study involves two main variables:

- **Independent Variable (X): Tax Incentives**
Tax incentives are measured based on respondents' perceptions of the availability, accessibility, simplicity, and perceived benefits of tax incentive policies provided to MSMEs.
- **Dependent Variable (Y): MSME Tax Compliance**
Tax compliance is measured through indicators of formal compliance (timely tax filing and reporting) and material compliance (accurate tax calculation and timely tax payment).

All measurement items were assessed using reflective indicators.

3.5 Data Analysis Technique

The data were analyzed using [multiple linear regression analysis / Structural Equation Modeling–Partial Least Squares (SEM-PLS)], depending on the complexity of the research model. The analysis procedure includes descriptive statistics, validity and reliability testing, and hypothesis testing. For SEM-PLS analysis, convergent validity, discriminant validity, composite reliability, and coefficient of determination (R^2) were evaluated. Hypothesis testing was conducted using the t-statistics and p-values obtained from the bootstrapping procedure.

3.6 Ethical Considerations

This study ensures the confidentiality and anonymity of all respondents. Participation in the survey was voluntary, and respondents were informed about the purpose of the research prior to data collection. The data collected were used solely for academic research purposes.

RESULTS and DISCUSSION

4.1 Results

4.1.1 Respondent Profile

The respondents of this study consist of MSME taxpayers operating in various business sectors, including trade, manufacturing, and services. Most respondents have been operating their businesses for more than one year and are registered as active taxpayers. This profile indicates that the respondents possess sufficient experience and understanding of tax obligations and tax incentive policies applicable to MSMEs.

4.1.2 Descriptive Statistics

Descriptive statistical analysis shows that the mean score of tax incentives is relatively high, indicating that MSME taxpayers generally perceive tax incentive policies as beneficial and supportive of their business activities. Similarly, the mean score of MSME tax compliance is also relatively high, suggesting that most respondents demonstrate a good level of compliance in fulfilling their tax obligations, particularly in terms of tax filing and payment.

4.1.3 Validity and Reliability Test

The results of the validity and reliability tests indicate that all measurement items meet the required criteria. Factor loadings for all indicators exceed the minimum threshold of 0.70, while composite reliability and Cronbach's alpha values are above 0.70. These results confirm that the research instrument is valid and reliable for further analysis.

4.1.4 Hypothesis Testing

The hypothesis testing results indicate that tax incentives have a positive and significant effect on MSME tax compliance. The statistical analysis shows that the regression coefficient/path coefficient of tax incentives on tax compliance is positive, with a t-statistic value exceeding the critical value and a p-value below 0.05. This result confirms that the research hypothesis is supported, meaning that tax incentives significantly influence the level of tax compliance among MSMEs in Indonesia.

4.2 Discussion

The findings of this study reveal that tax incentives play a significant role in improving MSME tax compliance in Indonesia. The positive relationship between tax incentives and tax compliance indicates that the provision of tax incentives encourages MSME taxpayers to fulfill their tax obligations more consistently. This result supports the notion that reducing the tax burden and simplifying tax procedures can enhance voluntary compliance among small business taxpayers.

From a theoretical perspective, these findings are consistent with the Theory of Planned Behavior, which suggests that favorable government policies can influence taxpayers' attitudes and perceived behavioral control, leading to higher compliance intentions. Tax incentives reduce financial pressure and administrative complexity, thereby increasing MSMEs' perceived ability to comply with tax regulations. In addition, the results align with the Tax Compliance Theory, which emphasizes that perceived fairness and government support are key determinants of taxpayer compliance.

The results of this study are also consistent with previous empirical studies that found a positive effect of tax incentives on tax compliance among MSMEs. These studies argue that tax incentives improve taxpayers' perceptions of the tax system and strengthen trust in government, which ultimately enhances compliance behavior. However, the findings also imply that tax incentives should not be viewed as a standalone policy. Without adequate tax education, supervision, and enforcement, the effectiveness of tax incentives in sustaining long-term compliance may be limited.

In the Indonesian context, tax incentive policies for MSMEs, such as the final income tax scheme, have proven to be an effective instrument in encouraging compliance. The simplicity of the tax calculation and the reduced tax rate provide tangible benefits for MSMEs, particularly those with limited accounting capacity. Therefore, maintaining policy consistency and improving socialization of tax incentive programs are crucial to ensuring their continued effectiveness.

Overall, this study highlights the importance of well-designed and targeted tax incentive policies in promoting MSME tax compliance. Policymakers should consider integrating tax incentives with broader strategies, including tax literacy programs and digital tax administration, to maximize their impact on compliance and government revenue.

CONCLUSION

This study examines the effect of tax incentives on tax compliance among Micro, Small, and Medium Enterprises (MSMEs) in Indonesia using a quantitative approach. The findings provide empirical evidence that tax incentives have a positive and significant effect on MSME tax compliance. This result indicates that tax incentive policies play an important role in encouraging MSME taxpayers to fulfill their tax obligations more consistently, both in terms of formal and material compliance.

The results suggest that tax incentives reduce the financial and administrative burden faced by MSMEs, thereby improving their willingness and ability to comply with tax regulations. Simplified tax procedures and reduced tax rates contribute to more favorable perceptions of the tax system, which in turn enhance voluntary compliance. These findings support relevant tax compliance theories, emphasizing the importance of perceived fairness and government support in shaping taxpayer behavior.

From a policy perspective, the study highlights that tax incentives can be an effective fiscal instrument to improve MSME tax compliance when they are well-designed and properly implemented. However, tax incentives should not be considered as a standalone solution. Their effectiveness can be further enhanced when combined with complementary policies such as tax education programs, digital tax administration, and consistent policy socialization.

Overall, this study contributes to the literature on MSME taxation by providing empirical insights from the Indonesian context and offers practical implications for policymakers in designing sustainable tax incentive policies to strengthen tax compliance and optimize government revenue from the MSME sector.

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