

DIGITALISATION OF MSMEs AND ITS IMPLICATION ON TAX COMPLIANCE

Loso Judijanto

IPOSS Jakarta, Indonesia

losojudijantobumn@gmail.com

Mahardika Catur Putriwana Malik

Universitas Khairun

mahardika@unkhair.ac.id

Abstract

Digitalisation of MSMEs is an important part of economic transformation by providing various benefits, such as increased operational efficiency, easier market access, and business growth opportunities. In the process, digitalisation also has implications for the level of tax compliance of business actors. The use of digital technology, such as automated transaction recording and financial platform integration, provides more transparency into MSME business activities, making monitoring by tax authorities easier. This article discusses how the digitalisation of MSMEs can drive tax compliance through better access to the tax system, while emphasising the importance of tax education for MSME players to optimally fulfil their tax obligations. The main conclusion shows that the adoption of digital technology by MSMEs not only drives business growth, but also becomes a key driver in realising higher tax compliance.

Keywords: Digitalisation, MSMEs, Tax Compliance.

Introduction

Micro, Small, and Medium Enterprises (MSMEs) have a strategic role in sustaining the national economy. Micro, Small, and Medium Enterprises (MSMEs) is a term used to describe business units with small to medium scale in a country's economy. The definition of MSMEs in Indonesia based on Law No. 20/2008 on Micro, Small, and Medium Enterprises, is grouped based on certain criteria, such as the amount of net worth, annual turnover, and the number of workers (Alm & Soled, 2016). Micro enterprises, for example, are businesses with a maximum net worth of IDR 50 million (excluding land and buildings) or an annual turnover of up to IDR 300 million. Meanwhile, small businesses have a net worth of more than IDR 50 million to IDR 500 million, with an annual turnover of more than IDR 300 million to IDR 2.5 billion. Medium-sized enterprises are above these categories, but still on a much smaller scale than large companies. This division of categories helps the government in providing appropriate support and policies according to the scale of the business (Santoro et al., 2020).

MSMEs play a vital role in economic growth, especially in developing countries like Indonesia. As a sector that contributes more than 60% of GDP and absorbs almost 97% of the workforce, MSMEs are the main motor of the people's economy. The existence of MSMEs not only provides employment opportunities, but also encourages

economic equality, especially in remote areas that are difficult to reach by large-scale businesses (Bornman & Wessels, 2020) . In addition, MSMEs contribute to strengthening national competitiveness through innovation and high-value local products. In the context of economic resilience, MSMEs have proven to be more adaptive in times of crisis, such as during the COVID-19 pandemic, where many MSMEs have transformed to digital-based business models. Therefore, the development of MSMEs is not only the responsibility of the government, but also the focus of the community and the private sector to encourage economic inclusiveness (Mukhlis et al., 2015)

However, MSMEs are not free from challenges such as the low level of digital technology adoption in their operational systems. This leads to limited market access, business efficiency, and delays in adapting to modern economic developments, especially during the digital era.

Along with that, the impact of technological development, the government began to encourage the digitalisation of MSMEs as a strategic step to improve efficiency, productivity, and competitiveness. Programs such as the *National Proud to Make Indonesia Movement* to digitalisation campaigns on e-commerce platforms have encouraged many MSMEs to switch to digital systems. Digitalisation allows MSMEs to expand their market through e-commerce, create new opportunities, and increase transparency in running a business. However, the transition to a digital ecosystem is not without challenges. One aspect of concern is the issue of tax compliance in the digital-based MSME ecosystem (Elmas et al., 2021) .

Most MSMEs still have a low level of tax literacy. Understanding the importance of taxes and reporting mechanisms is often an obstacle, especially when they have to adapt to a more complex digital system. Based on data from the Directorate General of Taxes (DGT), the level of tax compliance of Indonesian MSMEs is still relatively low, especially in terms of tax reporting and payment (Muslichah & Ramadania, 2020) . On the other hand, digitalisation can be a double-edged sword. On the one hand, digitalisation allows for better data transparency for tax purposes; but on the other hand, digitalisation can also pose a risk of data manipulation or tax reporting discrepancies if poorly understood by MSME actors (Abadi & Puspita, 2021) .

The implications for tax compliance are very important to consider in this digital era of MSMEs. With more and more MSMEs integrated on digital platforms, the government has great potential to increase tax revenue through a more structured system. However, to realise this, a comprehensive approach is needed, including tax education to MSME players, policies that support the ease of tax reporting, and technology integration that can encourage practical tax discipline (Djankov et al., 2010).

If not addressed properly, the low tax compliance of MSMEs in the digital ecosystem can create risks such as tax evasion, imbalance in state revenue, and obstacles to the growth of MSMEs themselves. Therefore, this research is crucial to

understand the relationship between the digitalisation of MSMEs and their level of tax compliance, as well as provide relevant policy recommendations in the current digital economy era.

Research Methods

The study in this research uses the literature method. The literature research method is a research approach that focuses on collecting, analysing, and synthesising information obtained from written sources such as books, scientific journals, research reports, articles, and other documents. This method aims to identify, understand, and evaluate ideas or findings relevant to the research topic (Machi & McEvoy, 2016) ; (Ridley, 2012) . Literature research is often used as a theoretical foundation to build conceptual frameworks, analyse research gaps, and enrich discussions in qualitative and quantitative research. Through this method, researchers can deepen their insights and find patterns or relationships between concepts that form the basis for developing further studies without having to involve direct field data collection. The selection of credible and verified sources is an important aspect to ensure the validity of the results of the literature research (Yuan & Hunt, 2009) .

Results and Discussion

The Relationship Between Digitalisation and Tax Compliance in MSMEs

Digitalisation has become a global phenomenon that affects various aspects of life, including the business sector. For Micro, Small, and Medium Enterprises (MSMEs), digitalisation offers a number of opportunities to improve operational efficiency, expand markets, and compete more effectively with larger companies. Digital transformation allows MSMEs to access e-commerce platforms, utilise social media for promotion, and implement more sophisticated management systems. On the other hand, digitalisation also brings challenges, such as the need for rapid adaptation to new technologies and changes in day-to-day business management. This makes digitalisation an important factor that can determine the success of an MSME in the modern era (Okunogbe & Pouliquen, 2022) .

Tax compliance is an important aspect of running a business legally and sustainably. For MSMEs, tax compliance means fulfilling tax obligations on time, paying the appropriate amount, and reporting income and expenses transparently. Good tax compliance ensures that MSMEs not only contribute to the country's economy through tax revenue, but also avoid potential sanctions that could arise from non-compliance. However, in many developing countries, including Indonesia, there are still significant challenges related to tax compliance among MSMEs, such as lack of understanding of taxation, high administrative costs, and fear of complicated bureaucracy (Gupta & Keen, 2015) .

One of the positive aspects of digitalisation is its ability to improve tax compliance among MSMEs. Digitalisation allows for more structured and transparent financial management, making it easier for MSMEs to track business transactions and revenue. With an automated bookkeeping system, the risk of errors in accounting records can be minimised, making the preparation of tax documents easier and more accurate. In addition, digitalisation allows direct integration with online taxation systems provided by the government, such as e-filing or mobile tax applications, simplifying the process of reporting and paying taxes, and increasing effectiveness and time efficiency (Agrawal & Fox, 2017).

While the benefits are great, digitalisation also presents some challenges for tax compliance. Access to technology is often a constraint for MSMEs, especially in less developed regions. In addition, specialised knowledge and skills are required to properly operate digital systems, which can require investment in training for MSME owners and employees. Technology adoption can also face cultural constraints, where there is resistance to changing from traditional to technology-based methods. Furthermore, data security is an important issue, where MSMEs must ensure that their financial information is protected from cyber threats (Arachi & Santoro, 2007).

The government plays a key role in encouraging digitalisation and improving tax compliance among MSMEs. Through policies that support technology infrastructure and provide incentives for MSMEs that adopt digital systems, the government can increase accessibility to such technology. In addition, education and mentoring programmes on digital taxation are essential to help MSMEs understand the new tax system and ensure their compliance. The government can provide a secure and easy-to-use platform, as well as provide adequate technical support to minimise technical obstacles that may be faced by MSMEs in the digitalisation process (Eichfelder & Vaillancourt, 2014).

MSMEs that adopt digital systems generally have higher levels of tax compliance. For example, several studies in various countries have shown that the implementation of digital technologies such as bookkeeping applications and tax software has successfully improved the accuracy and timeliness of tax reporting. In Indonesia, initiatives such as the use of e-commerce and digital payment platforms have helped many MSMEs to more easily track transactions and fulfil their tax obligations. This suggests that there is a positive correlation between digitalisation and increased tax compliance (Torgler, 2007).

Looking at existing trends, digitalisation has great potential to improve tax compliance in MSMEs more broadly in the future. With ever-evolving technological advancements, MSMEs can continue to innovate their business management systems, strengthening the link between daily business activities and tax regulation compliance. The development of new technologies such as blockchain and AI can provide more effective solutions in recording transactions and monitoring tax compliance in real-time.

In addition, the potential for closer collaboration between government, private sector, and MSME actors, can accelerate the adoption of digitalisation and strengthen tax compliance collectively (Baer & Le Borgne, 2008).

As such, digitalisation offers great opportunities for MSMEs to improve their tax compliance through operational efficiency and higher accessibility to technology. While there are challenges, with the right support from the government, private sector, and business community, MSMEs can overcome these barriers and make the most of digitalisation. Recommendations include improving technology infrastructure, continuous education and training for MSMEs, and providing tax incentives for MSMEs that implement digital systems. This synergy will not only improve tax compliance, but also strengthen MSME competitiveness in the global market.

Factors Affecting the Effectiveness of Digitalisation in Improving Tax Compliance

Digitalisation has become one of the main pillars in the transformation of government institutions, including taxation authorities. The effectiveness of digitalisation in improving tax compliance can be seen from various factors that influence its success. One of these factors is adequate technology infrastructure. Without a strong infrastructure, both in terms of hardware and software, digitalisation initiatives will not run properly. Fulfilling the need for this infrastructure is important to ensure that the tax system can be accessed by taxpayers easily and efficiently, thereby increasing convenience and reducing obstacles in the tax compliance process (Dabla-Norris et al., 2017).

In addition, the importance of digital literacy among taxpayers is a crucial factor in supporting the effectiveness of digitalisation. If taxpayers do not have adequate skills or knowledge on how to use the digital platforms provided by the government, this can reduce participation and compliance in paying taxes. Therefore, education and socialisation programmes are important elements that should not be ignored. The government should proactively improve people's digital literacy so that they can better utilise technology in fulfilling their tax obligations (Oseni, 2016).

Supportive regulations also play an important role in the digitisation process. A clear and firm policy on the use of technology in the taxation system can provide legal certainty for the public. The government needs to provide a policy framework that is adaptive to technological developments so that regulations do not become an obstacle in the implementation of digitalisation. In addition, the existence of incentive policies for those who obey paying taxes through the digital system can be an effective driver in increasing compliance (Herath & Mahmood, 2013).

Data security is another aspect that is no less important. Taxpayers should feel secure that their data is well protected by the system used by the government. Concerns about data leakage or misuse of personal information can deter people from utilising digital services. Thus, investment in sophisticated cybersecurity systems is an

absolute necessity to ensure public trust in the use of digital taxation platforms (Evans et al., 2014).

System interoperability between different agencies or divisions within the government can improve efficiency in tax data management. An integrated system allows data to be accessed and processed quickly, thus accelerating decision-making and reducing the possibility of errors in calculating or processing tax information. In addition, collaboration between the government and the private sector in developing new technologies can accelerate the transition to a fully digital tax system (Olsen et al., 2019).

The adoption of the latest technologies, such as the use of artificial intelligence and big data analytics, can enhance the effectiveness of digitalisation in taxation. With these technologies, tax authorities can profile taxpayers based on their data and identify potential non-compliance more quickly and accurately. This allows the government to conduct more targeted and efficient preventive or enforcement actions, which in turn can improve compliance rates (Colombo et al., 2013).

Intensive connection with end users, i.e. taxpayers, through feedback and responsive customer service can also play a role in the effectiveness of digitisation. By responding to feedback in a timely manner and fixing issues reported by users, the government can increase public satisfaction and trust in the digitalised system. Efficient customer service also helps answer questions and resolve doubts that taxpayers may face in carrying out their obligations online (Inasius., 2019)

Finally, strong government involvement and leadership is essential in steering the digitisation process. Visionary leadership and solid commitment from the government can provide the necessary direction and impetus to overcome the challenges that arise in the digital transformation process (Chen et al., 2015). Through careful planning and strategy implementation, the government can achieve the expected digitalisation goals and significantly improve tax compliance rates.

Conclusion

Digitalisation of MSMEs (Micro, Small and Medium Enterprises) brings significant positive impacts in improving the effectiveness and efficiency of business operations, from stock management to digital marketing. With the adoption of digital technology, MSMEs can more easily reach a wider market, both locally and globally. In addition, digitalisation also provides better access to financial services, such as digital banking and online lending platforms, which can help MSMEs grow faster. This transformation not only improves the competitiveness of MSMEs, but also boosts overall economic growth.

However, digitalisation also has direct implications for MSME tax compliance. With increased transparency in digital transactions, MSME players are more easily detected by tax authorities. Digital platforms such as marketplaces, electronic

payments, and automated point of sales systems facilitate transaction reporting and recording, thus helping MSMEs to be more compliant with tax obligations. In addition, the government is also increasingly active in integrating the tax system with the digital ecosystem to ensure that businesses pay taxes in a timely and accurate manner.

As such, the digitisation of MSMEs provides a great opportunity to drive business growth, but also raises expectations for tax compliance. Digital transformation makes monitoring by the government easier and minimises the potential for tax evasion. As such, MSMEs undergoing digitalisation need to ensure that they understand and fulfil their tax obligations, so that they can operate legally and contribute to national economic development.

Reference List

- Abadi, R. R. \, & Puspita, A. F. \. (2021). The Effect of Digital Transformation on Tax Compliance of MSMEs in Indonesia\, *Journal of Indonesian Economy and Business*\,36 \(\1\), 1-16. <https://doi.org/10.22146/jieb.60944>\.
- Agrawal, D. R. \, & Fox, W. F. \. (2017). Taxes in an e-commerce generation. *International Tax and Public Finance*,24 \(\5\), 903-926. <https://doi.org/10.1007/s10797-016-9422-3>\.
- Alm, J. \, & Soled, J. A. \. (2016). W(h)ither the Tax Gap? *New York University Law Review*\,91 \(\5\), 1153-1184.
- Arachi, G. \, & Santoro, A. \. (2007). Tax enforcement for SMEs: Lessons from the Italian experience?" *eJournal of Tax Research*\,5 \(\2\), 225-243.
- Baer, K. \, & Le Borgne, E. \. (2008). *Tax amnesties: Theory, trends, and some alternatives*.
- Bornman, M. \, & Wessels, J. \. (2020). The tax compliance decision of the individual in business in the sharing economy\, *eJournal of Tax Research*\,17 \(\2\), 63-86.
- Chen, J. V. \, Jubilado, R. J. M. \, Capistrano, E. P. S. \, & Yen, D. C. \. (2015). Factors affecting online tax filing - An application of the IS Success Model and trust theory. *Computers in Human Behaviour*\,43\ , 251-262. <https://doi.org/10.1016/j.chb.2014.11.017>\
- Colombo, M. G. \, Croce, A. \, & Grilli, L. \. (2013). ICT services and small businesses' productivity gains: An analysis of the adoption of broadband Internet technology. *Information Economics and Policy*,25 \(\3\), 171-189. <https://doi.org/10.1016/j.infoecopol.2012.11.001>\.
- Dabla-Norris, E. \, Misch, F. \, Cleary, D. \, & Khwaja, M. \. (2017). Tax Administration and Firm Performance: New Data and Evidence for Emerging Market and Developing Economies. *IMF Working Papers*\,17/95\ . <https://doi.org/10.5089/9781475595147.001>\.
- Djankov, S. \, Ganser, T. \, McLiesh, C. \, Ramalho, R. \, & Shleifer, A. \. (2010). The effect of corporate taxes on investment and entrepreneurship. *American Economic Journal: Macroeconomics*,2 \(\3\), 31-64. <https://doi.org/10.1257/mac.2.3.31>\.
- Eichfelder, S. \, & Vaillancourt, F. \. (2014). Tax compliance costs: A review of cost burdens and cost structures. *Hacienda Pública Española*,210 \(\3\), 111-148. <https://doi.org/10.7866/HPE-RPE.14.3.5>\

- Elmas, F. \, Aktas, N. \, & Sonuc, N. \. (2021). The Impact of Digital Transformation on Tax Compliance: A Study on SMEs\ *Journal of Accounting and Finance*\,22 \ (1), 19-34. <https://doi.org/10.25095/mufad.852001>
- Evans, C. \, Hansford, A. \, Hasseldine, J. \, Lignier, P. \, Smulders, S. \, & Vaillancourt, F. \. (2014). Small business and tax compliance costs: A cross-country study of managerial benefits and tax concessions\ *eJournal of Tax Research*\,12 \ (2), 453-482.
- Gupta, S. \, & Keen, M. \. (2015). Technology and Taxation in Developing Countries: From Hand to Mouse. *National Tax Journal*\,68 \ (3S), 735-766. <https://doi.org/10.17310/ntj.2015.3S.04>
- Herath, S. K. \, & Mahmood, R. \. (2013). Strategic orientation based research model of SME performance for developing countries. *Review of Integrative Business and Economics Research*\,2 \ (1), 430-440.
- Inasius, F. \. (2019). Factors Influencing SME Tax Compliance: Evidence from Indonesia\ *International Journal of Public Administration*\,42 \ (5), 367-379. <https://doi.org/10.1080/01900692.2018.1464578>
- Machi, L. A., & McEvoy, B. T. (2016). *The Literature Review: Six Steps to Success* (3rd ed.). Corwin.
- Mukhlis, I. \, Utomo, S. H. \, & Soesetio, Y. \. (2015). The role of taxation education on taxation knowledge and its effect on tax fairness as well as tax compliance on handicraft SMEs sectors in Indonesia\ *International Journal of Financial Research*\,6 \ (4), 161-169. <https://doi.org/10.5430/ijfr.v6n4p161>
- Muslichah, M. \, & Ramadania, R. \. (2020). The effect of tax socialisation, tax knowledge, and tax sanctions on taxpayer compliance. *Journal of Economics, Business, & Accountancy Ventura*\,23 \ (2), 194-206. <https://doi.org/10.14414/jebav.v23i2.2281>
- Okunogbe, O. M. \, & Pouliquen, V. \. (2022). Technology, taxation, and corruption: Evidence from the introduction of electronic tax filing. *American Economic Journal: Economic Policy*\,14 \ (1), 341-372. <https://doi.org/10.1257/pol.20190245>
- Olsen, J. \, Kasper, M. \, Kogler, C. \, Muehlbacher, S. \, & Kirchler, E. \. (2019). Mental accounting of income tax and value added tax among self-employed business owners. *Journal of Economic Psychology*\,70 \ , 125-139. <https://doi.org/10.1016/j.joep.2018.12.007>
- Oseni, M. \. (2016). Sustenance of tax administration by information and communications technology in Nigeria. *Archives of Business Research*\,4 \ (1), 47-54. <https://doi.org/10.14738/abr.41.1734>
- Ridley, D. (2012). *The Literature Review: A Step-by-Step Guide for Students* (2nd ed.). SAGE Publications Ltd.
- Santoro, F. \, Groening, E. \, Mdluli, D. \, & Shongwe, M. \. (2020). To formalise or not to formalise: Women-owned businesses in South Africa. *World Bank Policy Research Working Paper*,9292 \ . <https://doi.org/10.1596/1813-9450-9292>.
- Torgler, B. \. (2007). *Tax compliance and tax morale: A theoretical and empirical analysis*.
- Yuan, Y., & Hunt, R. H. (2009). Systematic Reviews: The Rationale and the Challenges of the Three Main Types of Reviews. *European Journal of Gastroenterology and Hepatology*, 21(6), 565–566.

