Volume: 11 Issues: 67 Special Issue [August, 2026] pp. 236 - 252
International Journal of Accounting, Finance and Business (IJAFB)
eISSN: 0128-1844
Journal website: www.academicinspired.com/ijafb
DOI: 10.55573/IJAFB.116717

FROM DIGITALIZATION TO COMPLIANCE: THE MEDIATING ROLE OF TAX KNOWLEDGE AND FINANCIAL REPORTING CAPABILITY AMONG MSMES IN INDONESIA

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Article history
Received date : 19-6-2026
Revised date : 20-6-2026
Accepted date : 25-7-2026
Published date : 1-8-2026

To cite this document:
Indriani, J. D., Yahaya, R., & Ahmad, N. L. (2026). From digitalization to compliance: The mediating role of tax knowledge and financial reporting capability among MSMEs in Indonesia. *International Journal of Accounting, Finance and Business (IJAFB),* 11 (67), 236 - 252.

Abstract: *Deploying digital breakthroughs across public tax administrations serves as a foundational strategy to drive higher rates of taxpayer compliance. Nevertheless, utilizing these digital tax portals poses a severe hurdle for small enterprises deficiencies in both their primary tax literacy and practical, day to day financial management proficiency. This research evaluates how Tax Digitalization and Tax Knowledge influence MSME Tax Compliance, while simultaneously examining the mediating function of Financial Reporting Capability. Utilizing a quantitative explanatory framework, this investigation collected primary empirical data by delivering structured questionnaires directly to a sample of 364 purposely chosen MSME owners situated in Bukittinggi City, West Sumatra, Indonesia. The statistical validation of the structural paths and the evaluation of the proposed hypotheses were executed empirically using PLS-SEM within the SmartPLS platform. The structural analysis revealed that Tax Knowledge and Financial Reporting Capability both exert a direct, statistically significant positive impact on MSME Tax Compliance, whereas Tax Digitalization does not directly drive compliance behavior. The statistical output demonstrates that Tax Digitalization acts as a strong driver for Financial Reporting Capability. As a result, this internal organizational capacity functions as a critical bridge that effectively transforms the use of digital tax tools into actual tax compliance outcomes. Conversely, Financial Reporting Capability fails to mediate the link between Tax Knowledge and Tax Compliance. These insights demonstrate that technological shifts in tax systems require robust financial reporting capacities within small businesses to translate digital adoption into actual compliance. From a theoretical perspective, this research enriches the TAM, TPB, and Compliance Theory by confirming that internal organizational capability serves as the missing link between digital exposure and rule adherence. From a* *practical standpoint, the empirical insights offer a clear framework for regulators to deliberately pair modern digital tax platforms with targeted financial capacity building programs for small businesses.*

Keywords: *Tax Digitalization; Tax Knowledge; Financial Reporting Capability; Tax Compliance; MSMEs.*

Introduction

Micro, Small, and Medium Enterprises (MSMEs) play a strategic role in supporting economic development, employment creation, and income distribution worldwide. However, despite their substantial contribution to economic activities, improving MSME tax compliance remains a persistent challenge, particularly in developing countries. The Organisation for Economic Co-operation and Development (OECD, 2021) reported that small business taxpayers often experience compliance barriers due to limited administrative capacity, lack of financial documentation, and difficulties in understanding tax regulations. This condition creates a gap between MSMEs' economic contribution and their participation in the formal taxation system.

In Indonesia, MSMEs represent one of the largest contributors to national economic activities. According to the Ministry of Cooperatives and SMEs of Indonesia (2023), MSMEs account for approximately 99% of total business units, contribute more than 60% to the national Gross Domestic Product (GDP), and absorb around 97% of employment. Nevertheless, the contribution of MSMEs to tax revenue remains relatively lower compared to their economic potential. This indicates that improving MSME tax compliance is not only related to increasing taxpayer awareness but also strengthening taxpayers' capability to fulfil taxation requirements.

Against this national background, Bukittinggi City was selected as the empirical setting because it reflects the characteristics of an urban economy where MSMEs play a dominant role in local economic activities. As one of the major commercial and tourism centres in West Sumatra, Bukittinggi is characterised by a high concentration of MSMEs engaged primarily in the trade, service, and hospitality sectors. These business characteristics require frequent interactions with the tax administration system, making the city an appropriate context for examining behavioural factors associated with tax compliance. Although this study focuses on a single city, the economic structure of Bukittinggi is comparable to many secondary cities in Indonesia where MSMEs constitute the backbone of local economic development. Consequently, the findings are expected to provide empirical insights that are relevant to regions with similar economic characteristics while acknowledging that their generalisation should be interpreted within comparable contexts.

The challenges of MSME tax compliance have become increasingly complex in the digital era. Many MSME owners still face limitations in understanding tax procedures, adopting digital taxation systems, and preparing reliable financial information needed for tax reporting. Previous studies have shown that compliance behavior is influenced by various factors, including technological adoption, taxpayer knowledge, and administrative capability (Night & Bananuka, 2020; Twum et al., 2022). Therefore, understanding the interaction among these factors is important to develop more effective strategies for improving voluntary tax compliance.

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Digital transformation in taxation has become a major strategy implemented by tax authorities to improve service quality, transparency, and taxpayer compliance. Digital tax systems, such as electronic registration, online payment, and electronic reporting, are expected to reduce compliance costs and simplify administrative processes. Based on the Technology Acceptance Model (TAM), individuals are more likely to adopt technology when they perceive it as useful and easy to use (Davis, 1989). In taxation, digitalization is expected to facilitate taxpayers in completing their obligations more efficiently.

Several empirical studies have confirmed the positive role of digital taxation in improving compliance. Okunogbe and Pouliquen (2022) found that electronic tax administration increases compliance by reducing administrative barriers and improving transparency. However, other studies indicate that digital technology adoption does not always directly lead to higher compliance because taxpayers require sufficient capability to utilize digital systems effectively (Nkundabanyanga et al., 2021). These inconsistent findings suggest that there may be other mechanisms explaining how digital transformation contributes to tax compliance, particularly among MSMEs.

In addition to digital factors, Tax Knowledge represents an important cognitive factor affecting taxpayer behavior. According to the Theory of Planned Behavior (TPB), individuals with higher knowledge and understanding tend to have stronger perceived behavioral control, which increases their ability to perform intended behaviors (Ajzen, 2020). In the taxation context, taxpayers who understand tax regulations, procedures, and obligations are expected to demonstrate better compliance behavior. Recent studies by Bornman and Wassermann (2022) and Twum et al. (2022) confirmed that tax knowledge significantly improves voluntary compliance among small business taxpayers.

However, having sufficient tax knowledge does not necessarily indicate that MSMEs have the ability to prepare accurate financial reports. Many MSME owners understand their taxation obligations but still experience difficulties in recording transactions, preparing financial statements, and providing reliable financial information. Financial Reporting Capability is therefore considered an essential organizational capability that supports taxpayers in calculating income, determining tax obligations, and completing tax reporting processes. From the perspective of Compliance Theory, taxpayer compliance depends not only on regulations and enforcement but also on taxpayers' capability to fulfil their obligations effectively.

Although previous studies have investigated the influence of tax digitalization and tax knowledge on compliance, several limitations remain. Most prior research focused on the direct relationship between technological or cognitive factors and compliance behavior, while limited attention has been given to the internal capability mechanism that enables MSMEs to transform digital adoption and tax understanding into actual compliance practices. Specifically, the mediating role of Financial Reporting Capability in the relationship between Tax Digitalization, Tax Knowledge, and Tax Compliance remains underexplored, particularly in the context of MSMEs in developing economies such as Indonesia.

Based on these research gaps, this study addresses the following research questions:

RQ1: How do Tax Digitalization and Tax Knowledge influence MSME Tax Compliance?

RQ2: How do Tax Digitalization and Tax Knowledge influence Financial Reporting Capability, and how does Financial Reporting Capability influence MSME Tax Compliance?

RQ3: How does Financial Reporting Capability mediate the relationship between Tax Digitalization, Tax Knowledge, and MSME Tax Compliance?

Based on these research questions, this study proposes seven hypotheses: Tax Digitalization positively influences Tax Compliance (H1); Tax Knowledge positively influences Tax Compliance (H2); Tax Digitalization positively influences Financial Reporting Capability (H3); Tax Knowledge positively influences Financial Reporting Capability (H4); Financial Reporting Capability positively influences Tax Compliance (H5); Financial Reporting Capability mediates the relationship between Tax Digitalization and Tax Compliance (H6); and Financial Reporting Capability mediates the relationship between Tax Knowledge and Tax Compliance (H7).

Therefore, this study aims to examine the influence of Tax Digitalization and Tax Knowledge on MSME Tax Compliance and investigate the mediating role of Financial Reporting Capability among MSMEs in Indonesia. This research contributes theoretically by integrating the Technology Acceptance Model (TAM), Theory of Planned Behavior (TPB), and Compliance Theory to explain MSME tax compliance behavior. Practically, this study provides insights for policymakers that digital taxation strategies should be supported by improving taxpayers' financial reporting capability to achieve sustainable voluntary compliance.

Literature Review

Tax compliance has become an important research topic in public finance and taxation because it determines the effectiveness of the taxation system and government revenue sustainability. Tax Compliance refers to taxpayers' willingness and ability to fulfil taxation obligations, including registration, accurate calculation, timely payment, and tax reporting according to applicable regulations. In the MSME context, compliance behavior is influenced not only by taxpayers' motivation but also by their knowledge, technological readiness, and administrative capability. Therefore, understanding MSME tax compliance requires an integrated theoretical approach involving behavioral, technological, and organizational perspectives.

This study integrates three theoretical perspectives: the Technology Acceptance Model (TAM), the Theory of Planned Behavior (TPB), and Compliance Theory. TAM explains how individuals accept and utilize technology based on perceived usefulness and perceived ease of use (Davis, 1989). TPB explains that individual behavior is determined by attitude, subjective norms, and perceived behavioral control, where knowledge strengthens individuals' ability to perform certain behaviors (Ajzen, 2020). Meanwhile, Compliance Theory emphasizes that compliance depends not only on external enforcement but also on taxpayers' internal capability and resources to meet regulatory requirements. The integration of these theories provides a comprehensive explanation of how digital systems, taxpayer cognition, and financial capability influence MSME tax compliance.

Tax Digitalization refers to the transformation of taxation services from manual processes into digital-based systems, including electronic registration, online tax payment, and electronic reporting. Digital taxation aims to improve accessibility, efficiency, transparency, and service quality. Based on TAM, digital tax systems can influence taxpayer behavior when users perceive the technology as useful and easy to operate. However, the effectiveness of digitalization depends on taxpayers' readiness and capability to utilize the system effectively.

Previous studies provide evidence regarding the relationship between digital taxation and tax compliance. Night and Bananuka (2020) found that electronic tax systems improve taxpayer compliance by increasing efficiency and reducing administrative difficulties. Similarly, Okunogbe and Pouliquen (2022) reported that electronic tax administration strengthens compliance through reduced transaction costs and improved transparency. However, some studies indicate that digital systems alone may not directly create compliance outcomes if taxpayers lack the necessary capability to use digital services effectively. Therefore, the following hypothesis is proposed:

H_1: Tax Digitalization has a positive effect on MSME Tax Compliance.

Tax Knowledge represents taxpayers' understanding of tax regulations, procedures, rights, and responsibilities. Tax knowledge enables taxpayers to correctly calculate tax obligations, understand reporting mechanisms, and avoid non-compliance caused by misunderstanding. From the TPB perspective, knowledge improves perceived behavioral control because taxpayers with sufficient information have greater confidence and ability to perform compliance behavior.

Several empirical studies confirm the important role of tax knowledge in improving compliance. Bornman and Wassermann (2022) explained that taxpayers with higher tax knowledge are more capable of making accurate compliance decisions. Twum et al. (2022) also found that tax knowledge significantly increases voluntary compliance among small and medium enterprise taxpayers. Based on these arguments, this study proposes:

H_2: Tax Knowledge has a positive effect on MSME Tax Compliance.

Financial Reporting Capability refers to MSMEs' ability to record transactions, prepare financial statements, and provide reliable financial information for decision-making and taxation purposes. In the context of taxation, financial reporting capability helps taxpayers identify income, calculate taxable amounts, and complete reporting obligations accurately. Compliance Theory suggests that taxpayers require adequate capability and resources before they can fulfil regulatory expectations.

Digitalization can strengthen financial reporting practices because digital systems require structured and accurate information. MSMEs that interact with digital taxation platforms need to improve their financial records to ensure that reported tax information reflects actual business conditions. Lutfi et al. (2022) demonstrated that digital technology adoption improves accounting processes, information accuracy, and financial management quality among SMEs.

Therefore, this study proposes:

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H3: Tax Digitalization has a positive effect on Financial Reporting Capability.

Tax Knowledge may also contribute to improving Financial Reporting Capability because taxpayers who understand taxation requirements tend to recognize the importance of accurate financial records. Knowledge about tax calculation and reporting procedures can encourage MSMEs to prepare better financial information to support compliance activities.

However, previous studies also suggest that tax knowledge and accounting capability represent different competencies. Understanding taxation regulations does not always mean that business owners have sufficient skills to prepare financial statements. Financial reporting requires accounting literacy, bookkeeping ability, and practical financial management skills. Therefore, examining this relationship provides further understanding of whether taxation knowledge contributes to MSME financial capability development. Thus, this study proposes:

H4: Tax Knowledge has a positive effect on Financial Reporting Capability.

Financial Reporting Capability is expected to directly influence MSME Tax Compliance because reliable financial information reduces uncertainty in fulfilling taxation obligations. MSMEs with systematic financial records are more capable of calculating business income, determining tax liabilities, and submitting accurate tax reports.

Previous research has emphasized the importance of accounting practices in supporting compliance behavior. Susanto and Meiryani (2023) found that financial information quality and accounting practices contribute to improving tax compliance among SMEs. This indicates that financial capability acts as an important internal factor that enables taxpayers to comply effectively. Therefore:

H5: Financial Reporting Capability has a positive effect on MSME Tax Compliance.

Although digital taxation provides technological infrastructure, its influence on compliance may depend on MSMEs' capability to transform digital processes into useful financial information. Digital systems can simplify administration, but taxpayers need adequate financial reporting capability to convert digital access into accurate compliance activities.

This study argues that Financial Reporting Capability serves as an internal mechanism linking technology adoption and compliance behavior. By integrating TAM and Compliance Theory, digitalization is expected to improve compliance through enhanced organizational capability. Therefore:

H6: Financial Reporting Capability mediates the relationship between Tax Digitalization and MSME Tax Compliance.

Furthermore, tax knowledge may encourage compliance through improved financial reporting practices. Taxpayers who understand taxation requirements may become more aware of the importance of maintaining financial records. However, the strength of this relationship depends on whether knowledge can be translated into practical financial capability.

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Therefore, this study examines Financial Reporting Capability as a mediating mechanism between Tax Knowledge and Tax Compliance. The proposed hypothesis is:

> **H_7: Financial Reporting Capability mediates the relationship between Tax Knowledge and MSME Tax Compliance.**

Previous literature has provided valuable insights into digital taxation, tax knowledge, and taxpayer compliance. However, most studies have focused on direct relationships between technological or behavioral factors and compliance outcomes. Limited studies have examined the mechanism through which internal organizational capability, particularly Financial Reporting Capability, transforms digitalization and taxpayer knowledge into actual compliance behavior. Therefore, this study fills this gap by developing an integrated model combining TAM, TPB, and Compliance Theory in the MSME taxation context.

Based on the theoretical foundation and hypothesis development, this study proposes a conceptual framework where Tax Digitalization and Tax Knowledge act as independent variables, Financial Reporting Capability functions as a mediating variable, and MSME Tax Compliance serves as the dependent variable. The model explains that sustainable tax compliance is achieved not only through digital transformation and taxpayer understanding but also through the ability of MSMEs to produce reliable financial information.

Methodology

This study employed a quantitative research approach with an explanatory research design to examine the relationship between Tax Digitalization, Tax Knowledge, Financial Reporting Capability, and MSME Tax Compliance. A quantitative approach was considered appropriate because this study aimed to test the proposed hypotheses and measure the causal relationships among latent variables using statistical analysis. The explanatory design enabled the researchers to evaluate both direct and indirect relationships among variables based on the proposed conceptual model integrating the Technology Acceptance Model (TAM), Theory of Planned Behavior (TPB), and Compliance Theory.

The study used primary data collected through a structured questionnaire distributed to Micro, Small, and Medium Enterprises (MSMEs) operating in Bukittinggi City, West Sumatra, Indonesia. The population consisted of officially registered MSMEs in Bukittinggi City. This study employed a purposive sampling technique by selecting respondents based on specific criteria relevant to the research objectives. The criteria included MSMEs that operated in Bukittinggi City, had been operating for at least two years, were officially registered, and had experience related to taxation activities. These criteria ensured that the selected respondents had sufficient knowledge and experience regarding digital taxation practices, financial reporting activities, and tax compliance obligations. After the data screening process, a total of 364 valid MSME respondents were obtained and analyzed in this study.

Data collection was conducted using a self-administered questionnaire consisting of measurement items adapted from previous validated studies. The questionnaire measured four main constructs: Tax Digitalization, Tax Knowledge, Financial Reporting Capability, and Tax Compliance. Each construct was measured using multiple indicators to ensure comprehensive representation of the theoretical concepts. Respondents evaluated each statement using a fivepoint Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree), which is commonly applied in behavioral and taxation studies to measure perceptions and attitudes.

The research instrument underwent validity and reliability assessment to ensure measurement quality. Content validity was evaluated by reviewing the suitability of questionnaire items based on previous literature and theoretical concepts. Furthermore, the measurement model was assessed using Partial Least Squares Structural Equation Modeling (PLS-SEM) by examining indicator reliability, internal consistency reliability, convergent validity, and discriminant validity. Indicator reliability was evaluated through outer loading values, while internal consistency was assessed using Cronbach's Alpha, rho_A, and Composite Reliability (CR). Convergent validity was determined using Average Variance Extracted (AVE), and discriminant validity was examined using the Heterotrait-Monotrait Ratio (HTMT), following the recommendations of Hair et al. (2022).

Data analysis was performed using SmartPLS software because PLS-SEM is suitable for examining complex models involving multiple latent variables, mediation relationships, and prediction-oriented research objectives. The analysis was conducted in two stages. First, the measurement model (outer model) was evaluated to confirm the reliability and validity of the constructs. Second, the structural model (inner model) was assessed to examine the relationships among Tax Digitalization, Tax Knowledge, Financial Reporting Capability, and Tax Compliance.

The structural model evaluation included the coefficient of determination (R^2), effect size (f^2), and hypothesis testing through the bootstrapping procedure. R^2 was used to evaluate the explanatory power of endogenous variables, while f^2 assessed the contribution of each predictor variable. The significance of direct and indirect relationships was determined based on path coefficient values, t-statistics, and p-values generated through bootstrapping analysis.

The hypotheses were considered statistically supported when the t-statistic exceeded 1.96 and the p-value was below the significance level of 0.05. The mediation analysis was conducted to examine the role of Financial Reporting Capability as a mediating variable between Tax Digitalization, Tax Knowledge, and MSME Tax Compliance. The specific indirect effect analysis from the bootstrapping procedure was used to determine mediation significance. This analytical procedure allowed the study to identify whether digital taxation and taxpayer knowledge influence compliance directly or indirectly through MSMEs' capability to prepare reliable financial reports. Therefore, the methodological approach applied in this study provides a systematic and replicable process for examining MSME tax compliance behavior in the digital transformation context.

Results

Respondent Profile

This study involved 364 Micro, Small, and Medium Enterprises (MSMEs) operating in Bukittinggi City, West Sumatra, Indonesia. The respondents consisted of MSME owners who were directly responsible for managing business operations, financial administration, and taxation activities. Therefore, the selected respondents were considered appropriate because

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they had relevant experience related to digital taxation services, financial reporting practices, and tax compliance decisions.

The respondents represented MSMEs with various business characteristics, including different business sectors, operational experience, and business scales. These characteristics provide empirical insights into how MSMEs respond to digital taxation transformation and how internal capabilities contribute to compliance behavior.

The MSME context in Bukittinggi City is particularly relevant because small businesses continue to face challenges related to financial administration, taxation understanding, and digital transformation readiness. Therefore, examining this context provides a deeper understanding of factors influencing MSME tax compliance in developing economies.

Descriptive Statistics

Descriptive statistical analysis was conducted to describe respondents' perceptions regarding Tax Digitalization, Tax Knowledge, Financial Reporting Capability, and Tax Compliance. The evaluation included mean, standard deviation, skewness, and kurtosis values before conducting SEM-PLS analysis. The results showed that Tax Digitalization obtained mean values ranging from 3.448 to 3.500, with standard deviation values between 1.215 and 1.243. These findings indicate that MSMEs have started adopting digital taxation services, including online-based tax administration. However, the moderate response level indicates that digital taxation implementation still requires further optimization to improve its effectiveness among MSME taxpayers. Tax Knowledge recorded mean values ranging from 3.442 to 3.676, with standard deviation values between 1.006 and 1.138. These findings suggest that MSME taxpayers have an adequate understanding of taxation procedures, regulations, and obligations. Continuous tax education remains important to improve taxpayers' capability to implement taxation knowledge correctly. Financial Reporting Capability obtained mean values between 3.390 and 3.525, with standard deviation values ranging from 1.099 to 1.196. The results indicate that MSMEs have begun applying financial recording practices, although improvements are still required in preparing systematic and reliable financial statements. Tax Compliance achieved the highest descriptive results, with mean values ranging from 3.723 to 3.849 and standard deviation values between 1.067 and 1.115. This indicates that MSMEs generally demonstrate positive compliance behavior in fulfilling taxation obligations, including tax calculation, payment, and reporting.

The skewness values ranged from -0.744 to -0.076, while kurtosis values ranged from -1.077 to 0.059. Since these values were within the acceptable range, the data did not indicate serious distribution issues and were appropriate for further analysis using PLS-SEM.

Measurement Model Evaluation (Outer Model)

The measurement model was first evaluated through reliability assessment using Cronbach's Alpha, rho_A, and Composite Reliability. Reliability values above 0.70 indicate acceptable internal consistency.

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Table 1. Internal Consistency Reliability

Construct	Cronbach Alpha	rho_A	Composite Reliability	Result
Financial Reporting Capability	0.854	0.857	0.896	Reliable
Tax Compliance	0.845	0.846	0.89	Reliable
Tax Digitalization	0.891	0.895	0.92	Reliable
Tax Knowledge	0.895	0.901	0.922	Reliable

Source: SmartPLS Output

All constructs exceeded the recommended reliability threshold. These findings confirm that all measurement items consistently represent their respective latent variables.

Convergent validity was evaluated using Average Variance Extracted (AVE).

Table 2. Convergent Validity

Construct	AVE	Result
Financial Reporting Capability	0.633	Valid
Tax Compliance	0.618	Valid
Tax Digitalization	0.697	Valid
Tax Knowledge	0.703	Valid

Source: SmartPLS Output

The AVE values of all constructs exceeded 0.50. Therefore, the measurement model fulfilled convergent validity requirements. Discriminant validity was assessed using the Heterotrait-Monotrait Ratio (HTMT).

Table 3. HTMT Results

Relationship	HTMT Value
Tax Compliance ↔ Financial Reporting Capability	0.604
Tax Digitalization ↔ Financial Reporting Capability	0.319
Tax Digitalization ↔ Tax Compliance	0.437
Tax Knowledge ↔ Financial Reporting Capability	0.251
Tax Knowledge ↔ Tax Compliance	0.438
Tax Knowledge ↔ Tax Digitalization	0.621

Source: SmartPLS Output

Structural Model Evaluation (Inner Model)

After confirming the reliability and validity of the measurement model, the next stage involved evaluating the structural model to examine the predictive capability and relationships among constructs. The structural model assessment was conducted by analyzing the coefficient of determination (R^2), effect size (f^2), and path coefficient significance through the bootstrapping procedure.

The coefficient of determination (R^2) was evaluated to determine the explanatory power of the structural model. The results showed that Tax Digitalization and Tax Knowledge explained 8.7% of the variance in Financial Reporting Capability ($R^2 = 0.087$). This low figure indicates weak explanatory power, revealing that external factors outside this framework primarily drive small business financial reporting capabilities. Meanwhile, Tax Digitalization, Tax

Knowledge, and Financial Reporting Capability explained 35.5% of the variance in Tax Compliance ($R^2 = 0.355$). This indicates that the proposed model has moderate predictive ability in explaining MSME tax compliance behavior.

The f^2 assessment was conducted to evaluate the individual contribution of each predictor variable. The findings indicate that Financial Reporting Capability had the strongest effect on Tax Compliance ($f^2 = 0.258$), representing a medium effect size. Meanwhile, Tax Digitalization and Tax Knowledge demonstrated small effects on Tax Compliance. These findings indicate that MSMEs' internal capability in preparing financial reports plays a more substantial role in improving tax compliance compared with digital and knowledge factors alone.

Table 4. Direct Effect Results

Hypothesis	Relationship	β	T Statistics	P Values	Decision
H1	TD → TC	0.141	1.727	0.084	Rejected
H2	TK → TC	0.212	2.78	0.005	Supported
H3	TD → FRC	0.234	2.893	0.004	Supported
H4	TK → FRC	0.092	1.035	0.301	Rejected
H5	FRC → TC	0.427	6.943	0	Supported

Source: SmartPLS Output

The results demonstrate that Tax Digitalization does not significantly influence Tax Compliance; therefore, H1 was rejected. Tax Knowledge significantly affects Tax Compliance, supporting H2. Furthermore, Tax Digitalization significantly improves Financial Reporting Capability; therefore, H3 was supported. However, Tax Knowledge does not significantly affect Financial Reporting Capability; therefore, H4 was rejected. Financial Reporting Capability demonstrated the strongest positive influence on Tax Compliance; therefore, H5 was supported.

Table 5. Specific Indirect Effects

Hypothesis	Relationship	β	T Statistics	P Values	Decision
H6	TD → FRC → TC	0.1	2.46	0.014	Supported
H7	TK → FRC → TC	0.039	1.049	0.294	Rejected

Financial Reporting Capability significantly mediates the relationship between Tax Digitalization and Tax Compliance. However, Financial Reporting Capability does not mediate the relationship between Tax Knowledge and Tax Compliance.

Discussion

The Influence of Tax Digitalization and Tax Knowledge on MSME Tax Compliance (RQ_1)

The first research question examined how Tax Digitalization and Tax Knowledge influence MSME Tax Compliance. The results revealed that Tax Digitalization had a positive but insignificant effect on Tax Compliance (β = 0.141; t = 1.727; p = 0.084), indicating that H1 was rejected. Meanwhile, Tax Knowledge showed a positive and significant effect on Tax Compliance (β = 0.212; t = 2.780; p = 0.005), supporting H2.

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The insignificant effect of Tax Digitalization indicates that the availability of digital taxation systems does not automatically improve compliance behavior among MSMEs. From the perspective of the Technology Acceptance Model (TAM), technology adoption requires not only system availability but also perceived usefulness, perceived ease of use, and users' ability to integrate technology into daily business practices. Therefore, although digital tax platforms simplify administrative procedures, MSMEs require sufficient capability to utilize these systems effectively.

This finding differs from Mbise and Baseka (2022), who found that digital tax administration systems significantly improved compliance among SMEs by simplifying reporting procedures and improving interaction between taxpayers and tax authorities. Similarly, Putri et al. (2025) showed that tax digitalization positively influenced MSME taxpayer compliance. The different result in this study may be explained by the characteristics of MSMEs in Bukittinggi, where digital tax adoption may still be at a transitional stage. Access to digital platforms does not guarantee compliance when taxpayers have limitations in digital skills, financial documentation, and practical understanding of online taxation processes. Therefore, digital transformation requires supporting capabilities before generating compliance outcomes.

In contrast, Tax Knowledge significantly improved MSME Tax Compliance. This result supports the Theory of Planned Behavior (TPB), which explains that knowledge strengthens perceived behavioral control. MSME taxpayers with better understanding of tax regulations, calculation procedures, and reporting mechanisms have higher confidence and ability to comply voluntarily. This finding is consistent with Twum et al. (2022), who demonstrated that tax knowledge plays an important role in improving compliance among small and medium enterprises. The result is also supported by previous evidence showing that taxpayers with sufficient knowledge are more capable of making accurate tax decisions and reducing unintentional non-compliance.

The Role of Tax Digitalization, Tax Knowledge, and Financial Reporting Capability in Improving MSME Tax Compliance (RQ_2)

The second research question investigated whether Tax Digitalization and Tax Knowledge influence Financial Reporting Capability and how Financial Reporting Capability contributes to MSME Tax Compliance. The findings showed that Tax Digitalization significantly influenced Financial Reporting Capability ($\beta = 0.234$; $t = 2.893$; $p = 0.004$), supporting H3. However, Tax Knowledge had no significant effect on Financial Reporting Capability ($\beta = 0.092$; $t = 1.035$; $p = 0.301$), indicating that H4 was rejected. Furthermore, Financial Reporting Capability significantly influenced Tax Compliance ($\beta = 0.427$; $t = 6.943$; $p < 0.001$), supporting H5.

The significant effect of Tax Digitalization on Financial Reporting Capability indicates that digital transformation encourages MSMEs to improve their financial administration practices. Digital taxation requires accurate transaction records and reliable financial information; therefore, MSMEs involved in digital tax systems tend to develop more structured financial management processes. This finding is aligned with Lutfi et al. (2022), who found that digital technology adoption improves accounting processes, information accuracy, and financial management quality among SMEs. In addition, recent studies on digital accounting adoption indicate that digital systems improve the quality of accounting information by supporting faster

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and more systematic financial recording. However, Tax Knowledge did not significantly influence Financial Reporting Capability. This finding suggests that understanding taxation rules does not necessarily increase MSMEs' technical ability to prepare financial statements. Tax knowledge focuses on taxpayers' understanding of obligations, procedures, and regulations, whereas financial reporting capability requires specific accounting skills, bookkeeping practices, and financial management experience. The difference between this result and previous studies may occur because many MSME owners manage taxation and accounting activities independently. They may understand when and why taxes should be paid but still experience difficulties in converting business transactions into formal financial reports.

The strong influence of Financial Reporting Capability on Tax Compliance confirms that internal capability is an essential factor in compliance behavior. Based on Compliance Theory, taxpayers need adequate resources and capability to comply effectively. Reliable financial reports enable MSMEs to calculate taxable income, identify obligations, and submit accurate tax information. Therefore, improving MSME tax compliance should not only focus on increasing awareness or providing digital systems but also strengthening financial reporting capacity.

The Mediating Role of Financial Reporting Capability between Tax Digitalization, Tax Knowledge, and MSME Tax Compliance (RQ_3)

The third research question examined the mediating role of Financial Reporting Capability. The results demonstrated that Financial Reporting Capability significantly mediated the relationship between Tax Digitalization and Tax Compliance ($\beta = 0.100$; $t = 2.460$; $p = 0.014$), supporting H6. However, Financial Reporting Capability did not mediate the relationship between Tax Knowledge and Tax Compliance ($\beta = 0.039$; $t = 1.049$; $p = 0.294$), rejecting H7.

The significant mediation effect provides the main contribution of this study. Although Tax Digitalization did not directly influence Tax Compliance, digitalization improved compliance indirectly through Financial Reporting Capability. This finding explains that technology adoption creates compliance outcomes when MSMEs have the ability to transform digital processes into accurate financial information. This result extends the Technology Acceptance Model by showing that technology effectiveness depends on organizational capability. Digital systems provide infrastructure and efficiency, but financial reporting capability enables MSMEs to convert digital advantages into practical compliance behavior.

Therefore, the effective pathway identified in this study is:

Tax Digitalization → Financial Reporting Capability → Tax Compliance

Even with these results, the structural model warns that Tax Digitalization and Tax Knowledge capture just 8.7% of the variance in Financial Reporting Capability ($R^2 = 0.087$). This low metric means we must interpret the mediation path with care since the framework covers only a fraction of the forces shaping MSME accounting capacities. While the indirect path remains statistically significant, unmeasured external variables clearly dictate the bulk of financial reporting outcomes.

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eISSN: 0128-1844
Journal website: www.academicinspired.com/ijafb
DOI: 10.55573/IJAFB.116717

Leaving 91.3% of the variance unexplained points to a much deeper mix of internal and external drivers. On the inside, factors like core accounting competence, owners' education levels, digital literacy, and firm size likely carry the real weight. On the outside, elements such as direct access to accounting software, state-sponsored assistance programs, professional advisory networks, and institutional pressures probably play a far more substantial role in building financial reporting capability than tax tech or basic tax knowledge alone.

The dead-end mediation path between Tax Knowledge and Tax Compliance proves that tax education drives compliance through direct behavioral decisions rather than structural bookkeeping changes. Aligning with the Theory of Planned Behavior, tax literacy strengthens perceived behavioral control by helping small business owners decipher rules and make informed choices to comply. Yet, building true financial reporting capabilities demands comprehensive accounting skills that go far beyond tax laws. Tax training alone will not fix poor financial management habits or a lack of organizational resources.

Ultimately, Financial Reporting Capability serves as a valid but modest mediator in this framework. Future researchers should integrate broader organizational, technological, and institutional metrics. This will help build a more powerful model to explain what truly shapes MSME accounting performance.

Theoretical Implications

This study provides several theoretical contributions. First, it extends the Technology Acceptance Model (TAM) by demonstrating that digital tax adoption does not automatically create compliance behavior. Technology requires supporting organizational capability, particularly Financial Reporting Capability, before influencing taxpayer outcomes.

Second, this study strengthens the Theory of Planned Behavior (TPB) by confirming that Tax Knowledge acts as a cognitive factor that improves taxpayers' ability and confidence to comply voluntarily.

Third, this study expands Compliance Theory by identifying Financial Reporting Capability as an internal capability mechanism that connects digital transformation with tax compliance. This finding highlights that compliance depends not only on regulations and technology but also on taxpayers' administrative readiness.

Practical and Policy Implications

The findings provide important implications for tax authorities and policymakers. Digital taxation policies should not only focus on expanding online tax systems but also improving MSMEs' capability to use these systems effectively.

Tax authorities should integrate digital tax transformation with financial literacy programs, bookkeeping assistance, and digital accounting training. Strengthening MSME financial reporting capability will help business owners prepare accurate financial information and improve sustainable compliance.

For MSME owners, the findings highlight the importance of developing internal financial management systems. Better financial reporting practices enable businesses to fulfil tax obligations more accurately and efficiently.

Limitations and Future Research

This study has several limitations. First, the research focused only on MSMEs in Bukittinggi City, Indonesia. Therefore, future studies should involve MSMEs from different regions and industrial sectors to improve the generalizability of findings.

Second, this study used a quantitative approach based on questionnaire data. Future research could apply mixed-method approaches by including interviews to explore deeper behavioral and organizational factors affecting MSME tax compliance.

Third, this study focused on Tax Digitalization, Tax Knowledge, and Financial Reporting Capability. Future studies may include additional variables such as digital accounting adoption, financial literacy, trust in tax authorities, perceived fairness, and taxpayer motivation to develop a more comprehensive compliance model.

Acknowledgements

The authors would like to express sincere appreciation to all parties who contributed to the completion of this research. Special gratitude is extended to the academic supervisors for their valuable guidance, constructive feedback, and continuous support throughout the research process. The authors also acknowledge the support and assistance provided by the Department of Cooperatives and Micro, Small, and Medium Enterprises of Bukittinggi City, West Sumatra, Indonesia, in facilitating access to MSME respondents. The authors are particularly grateful to all MSME owners who voluntarily participated in this study and provided valuable information regarding digital taxation practices, financial reporting activities, and tax compliance behavior. Their participation contributed significantly to the development of empirical evidence on MSME tax compliance in the digital transformation era.

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