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The Effect of Tax Incentives on Microenterprise Performance with Tax Compliance as a Mediating Variable

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Abstract
This study aims to analyze the effect of tax incentives on the performance of microenterprises, with tax compliance as a mediating variable. The study employs a quantitative approach with an explanatory design and uses secondary data from Statistics Indonesia covering six administrative areas of DKI Jakarta Province during the 2021–2024 period, resulting in 24 region-year observations. The data were analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM). The results show that tax incentives do not have a significant direct effect on microenterprise performance but have a positive and significant effect on tax compliance. Tax compliance, in turn, has a positive and significant effect on microenterprise performance and significantly mediates the effect of tax incentives on microenterprise performance. These findings confirm that the effectiveness of tax incentives operates primarily through improved tax compliance rather than through a direct effect on performance. This study contributes theoretically by strengthening the role of tax compliance as a mechanism linking fiscal policy and microenterprise performance. Practically, the findings imply that tax incentive policies should be accompanied by easier access, simplified administrative procedures, tax education, and strengthened digital services to improve compliance and support microenterprise performance more effectively.

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1. INTRODUCTION

Microenterprises play a strategic role in the Indonesian economy as they are a key pillar of employment, household income generation, and strengthening local economic activity. Within the national business structure, microenterprises function not only as small-scale business units but also as a vital part of the production and distribution system that supports the economic resilience of the community. Nevertheless, microenterprises still face various limitations, particularly in terms of capital, productivity, financial record-keeping, market access, administrative capabilities, and compliance with tax obligations. This situation indicates that microenterprise performance is influenced not only by internal business factors but also by public policy support, including taxation policies.

In the context of taxation, tax incentives are one fiscal instrument that the government can use to support the sustainability and growth of micro-enterprises. Tax incentives are essentially provided to reduce the fiscal burden, increase liquidity, and encourage businesses to be more resilient and grow. For micro-enterprises with limited capital and administrative resources, tax incentives are crucial because they can help reduce the pressure on business costs and provide an incentive to enter the formal tax system. Thus, tax incentives serve not only as a form of fiscal relief but also as a policy instrument with the potential to shape more orderly and sustainable business behavior.

However, the effectiveness of tax incentives on micro-enterprise performance is not always straightforward. Tax incentives can provide benefits if business actors understand, access, and utilize them appropriately. In practice, some micro-enterprises still face challenges in understanding tax regulations, maintaining business records, and fulfilling tax administration obligations. Therefore, the relationship between tax incentives and micro-enterprise performance needs to be examined through the mechanism of tax compliance behavior. Tax compliance is a crucial factor because compliant businesses tend to have more orderly administration, a lower risk of sanctions, and greater opportunities to access financing, partnerships, and government programs.

This study uses the Theory of Planned Behavior (TPB) developed by Ajzen (1991) as a theoretical basis to explain the tax compliance behavior of micro-enterprises. TPB explains that individual behavior is influenced by three main factors: attitudes toward behavior, subjective norms, and perceived behavioral control. In the context of taxation, micro-enterprise tax compliance can be understood as behavior formed from perceptions of the benefits of tax incentives, encouragement from the tax environment or authorities, and ease in fulfilling tax administration obligations. Tax incentives can shape positive attitudes because they reduce the fiscal burden and provide economic benefits for business actors. In addition, easy access and socialization of incentives can increase business actors' perceptions of control in carrying out tax obligations. Thus, TPB is relevant for use in this study because it can explain that tax incentives do not always have a direct impact on the performance of micro-enterprises, but first shape tax compliance behavior, which then contributes to improving micro-enterprise performance.

Previous research has shown that tax incentives are related to the performance and compliance of micro, small, and medium enterprises. Afandi et al. (2023) found that tax incentives can play a role in improving MSME performance, particularly when linked to the business's ability to adapt and innovate. Sumiok (2023) demonstrated that tax policy is related to the financial performance and compliance of MSMEs in Indonesia. Furthermore, Saptono et al. (2024) emphasized that tax incentives, creative compliance, and innovation can strengthen the sustainability of MSMEs. These findings demonstrate that tax incentives are not simply understood as policies to reduce the tax burden, but also as factors that can influence compliance behavior and business performance.

However, there are still research gaps that require further study. Most previous studies still position tax incentives as variables that directly influence MSME performance, while the indirect mechanism through tax compliance has not been specifically explained, especially in the context of micro-enterprises. However, based on the Theory of Planned Behavior perspective, tax compliance is a behavior influenced not only by legal obligations but also by business actors' attitudes toward the benefits of tax policies, norms established by the environment and tax authorities, and perceptions of ease in fulfilling tax obligations. Therefore, tax compliance plays a crucial role as a bridging mechanism between tax incentives and micro-enterprise performance.

Another research gap lies in data utilization. Research on tax incentives and MSME compliance generally utilizes primary data through surveys of business actors' perceptions. Meanwhile, secondary data-based research linking tax incentives, tax compliance, and microenterprise performance at the regional level is still relatively limited. Furthermore, most previous studies have positioned tax compliance as a dependent variable, rather than a mediating variable. Therefore, this study seeks to address this gap by positioning tax compliance as a mediating variable in the influence of tax incentives on microenterprise performance.

Based on the above description, this study aims to analyze the effect of tax incentives on the performance of micro-enterprises, with tax compliance as a mediating variable. This study uses secondary data from the Central Statistics Agency (BPS) for six administrative regions of DKI Jakarta Province during the 2021–2024 period. This study is expected to provide theoretical contributions in strengthening understanding of the role of tax compliance as a connecting mechanism between tax incentive policies and micro-enterprise performance. Furthermore, this study is also expected to provide practical implications for the government and tax authorities in designing incentive policies that are not only fiscal in nature but also capable of increasing compliance, strengthening business governance, and promoting sustainable micro-enterprise performance.

2. METHOD

This research is based on the premise that microenterprise performance is not solely determined by internal business capabilities but is also influenced by the fiscal policy environment and business actors' behavioral responses to the tax system. In this context, tax incentives are positioned as fiscal instruments with the potential to reduce business burdens and provide space for the sustainability of economic activity, while tax compliance is positioned as a behavioral mechanism that can bridge the benefits of these policies with microenterprise performance. To systematically explain the relationships between variables, this research utilizes a multilevel theoretical framework consisting of grand theory, middle theory, and applied theory.

The grand theory in this study is the Theory of Planned Behavior (TPB) developed by Ajzen (1991). TPB explains that individual behavior is related to behavioral intentions formed by three main determinants, namely attitude toward behavior, subjective norm, and perceived behavioral control. Attitude toward behavior describes an individual's positive or negative evaluation of a behavior; subjective norm reflects the perception of social pressure or expectations to act, while perceived behavioral control shows the individual's perception of the ability, ease, or obstacles in carrying out the behavior (Ajzen, 1991).

In the context of micro-enterprise taxation, the TPB provides a basis for explaining that tax compliance does not arise solely from legal obligations. Compliance behavior can be related to business actors' attitudes toward the tax system, normative pressures from the environment and tax authorities, and perceptions of their ability to understand and fulfill tax obligations. Tax incentives perceived as providing economic benefits can shape a more positive evaluation of the tax system. On the other hand, socialization, ease of procedures, administrative support, and access to facilities can increase business actors' perceptions of control in fulfilling tax obligations.

Based on the TPB perspective, tax compliance's position as a mediating variable is theoretically sound because tax incentives do not necessarily automatically lead to improved micro-enterprise performance. These policies can first influence business actors' perceptions and responses to the tax system, which are then reflected in compliance behavior. When business actors perceive tax policies as beneficial and enforceable within their administrative capabilities, their tendency to engage more systematically in the formal system may increase. Thus, the TPB is used to explain the behavioral mechanisms linking tax incentives, tax compliance, and micro-enterprise performance.

At the middle-theory level, this study uses a tax compliance perspective to explain taxpayers' decisions to fulfill their tax obligations. One of the classic foundations in the tax compliance literature was developed by Allingham and Sandmo (1972), who analyzed income reporting and tax avoidance decisions through consideration of economic benefits, the probability of audit, and the consequences or sanctions faced by taxpayers. This perspective demonstrates that tax behavior is the result of a decision-making process and not merely an automatic response to legal provisions.

Although Allingham and Sandmo's (1972) approach emphasized economic calculations, developments in compliance studies indicate that taxpayer behavior also needs to be understood through non-economic factors. In this study, this expansion is bridged by the TPB, so that micro-enterprise compliance is understood through a combination of benefit considerations, policy perceptions, normative influences, and administrative capabilities. This integrative approach is relevant for micro-enterprises because limitations in resources, information, record-keeping, and administrative capabilities can influence business actors' decisions in fulfilling their tax obligations.

In this context, tax incentives can alter the perceived benefits and burdens of business actors. When incentives are understood as facilities that provide tangible and accessible benefits, perceptions of the tax system can become more positive. This situation has the potential to encourage more orderly engagement in the formal system. Conversely, if policies are difficult to understand or require procedures perceived as exceeding the administrative capacity of micro-business actors, the presence of incentives may not necessarily result in changes in compliance behavior.

Empirical support for this relationship has been found in several previous studies. Sumiok (2023) examined the relationship between tax policy components and the financial performance and compliance of MSMEs in Indonesia. Basri et al. (2023) demonstrated that tax incentives are related to MSME taxpayer compliance in the context of research conducted during the pandemic. Saptono et al. (2024) further demonstrated the importance of the relationship between tax incentives, creative compliance, and innovation in explaining the resilience and sustainability of MSMEs. These findings suggest that compliance responses are crucial in understanding how businesses react to tax policies.

Unlike studies that position compliance as the outcome of tax policy, this study positions tax compliance as a mediating variable. This position is based on the argument that tax incentives can first shape compliance responses before policy benefits are translated into micro-enterprise performance. Thus, a tax compliance perspective provides a basis for examining the indirect mechanisms between tax incentives and micro-enterprise performance.

Fiscal Policy Theory is used to explain tax incentives as part of the government's fiscal policy instruments. Musgrave (1959) explained the role of public finance through its allocation, distribution, and stabilization functions. Within this framework, tax policy not only functions as a mechanism for collecting state revenue but also as a government instrument for influencing resource allocation, welfare distribution, and the stability of economic activity. Therefore, tax incentives can be understood as a form of fiscal intervention designed to influence the economic conditions and decisions of specific target groups.

In the context of micro-enterprises, tax incentives are relevant because this business group generally has limited capital, administrative capacity, and resilience to economic pressures. Conceptually, reducing or easing the fiscal burden can provide businesses with the space to maintain available resources and support operational activities. However, the existence of incentives does not automatically guarantee improved performance, as the effectiveness of the policy also depends on the accessibility, understanding, utilization, and ability of businesses to comply with the accompanying requirements.

Afandi et al. (2023) demonstrated that tax incentives are related to the performance of Indonesian MSMEs and identified the role of innovation as a mediator in this relationship. This finding is significant because it suggests that the influence of tax incentives on performance can occur through an intermediary mechanism. Saptono et al. (2024) also demonstrated that tax incentives interact with creative compliance and innovation in building MSME resilience and sustainability. Meanwhile, Sumiok (2023) linked tax policy aspects to MSME performance and compliance.

This research expands on this literature by proposing a more specific mediating mechanism: tax compliance. Conceptually, tax incentives, as a fiscal instrument, can reduce the pressure felt by business actors and increase the perceived benefits of engaging in the formal system. If these changes encourage better compliance, administrative order and business management can be strengthened, potentially supporting micro-enterprise performance in the future. Thus, Fiscal Policy Theory provides the basis for positioning tax incentives as a policy antecedent in the research model.

At the applied theory level, this study uses the MSME Performance Perspective to explain the performance of micro-enterprises as a result of the interaction between policy support and the behavioral responses of business actors. The use of the term performance perspective is based on the view that business performance is a multidimensional construct. Venkatraman and Ramanujam (1986) distinguish the scope of business performance as not limited to financial indicators, but can be expanded to operational indicators that reflect the position and achievements of business activities. This perspective is relevant for micro-enterprises because limitations in recording systems often prevent performance evaluation from relying solely on profitability measures or formal financial ratios.

In this study, microenterprise performance is understood as an achievement reflecting business capacity, involvement in economic activities, beneficial partnerships, and the microenterprise's position within the regional economic structure. This approach better aligns with the nature of regionally based secondary data and the characteristics of microenterprises than approaches that solely measure the profitability of large firms. Therefore, microenterprise performance is treated as a construct that represents broader business performance in line with the empirical characteristics of the research object.

Empirical support for the relationship between tax policy and MSME performance is found in research by Afandi et al. (2023), who examined the relationship between tax incentives, innovation, and MSME performance and demonstrated the existence of a mediating mechanism through innovation. Sumiok (2023) also examined the relationship between tax policy components and the financial performance and compliance of MSMEs in Indonesia. Furthermore, Saptono et al. (2024) demonstrated that the success and sustainability of MSMEs are related to the interaction between tax incentives, creative compliance, innovation, resilience, and business continuity. This literature emphasizes that MSME performance does not stand alone but is influenced by external policies and the ability of business actors to respond to and translate these policies into business behavior and processes.

Based on the integration of these theories, this study develops an argument that tax incentives can influence the performance of micro-enterprises through both direct and indirect channels. Fiscal Policy Theory explains the position of tax incentives as a government policy instrument that can influence the economic conditions of business actors. The Theory of Planned Behavior explains the process of forming behavioral responses through attitudes, subjective norms, and perceived behavioral control. The tax compliance perspective explains how business actors make decisions to engage and fulfill obligations in the tax system. Furthermore, the MSME Performance Perspective explains business achievements as results that can be reflected through performance dimensions that are in accordance with the characteristics of micro-enterprises.

The indirect pathway is the primary focus of this research. Tax incentives are expected to increase perceived benefits and reduce barriers experienced by businesses in interacting with the tax system. These changes can encourage better tax compliance. Furthermore, compliance can be linked to administrative regularity, reduced risk of sanctions, and strengthened business involvement in the formal system, which ultimately can support micro-enterprise performance. Therefore, tax compliance is positioned as a mediating variable in the relationship between tax incentives and micro-enterprise performance.

Based on the theoretical framework and empirical studies, the research hypothesis is formulated as follows:

H1: Tax incentives have an impact on the performance of micro-enterprises.

H2: Tax incentives have an impact on micro-enterprise tax compliance.

H3: Tax compliance affects the performance of micro-enterprises.

H4: Tax compliance mediates the effect of tax incentives on micro-firm performance.

This study uses a quantitative explanatory approach with secondary data sourced from the Central Statistics Agency (BPS) publication on Micro and Small Industries in DKI Jakarta Province for the 2021–2024 period. The analysis unit covers six administrative regions in DKI Jakarta Province, resulting in 24 area-year observations. The research variables consist of tax incentives as the independent variable, tax compliance as the mediating variable, and micro-enterprise performance as the dependent variable. The data are compiled based on available and relevant indicators in BPS publications to describe conditions at the aggregate regional level; therefore, interpretation of the constructs and research results is limited to the regional level of analysis, not the individual behavior of each micro-enterprise.

Data analysis was conducted using Partial Least Squares-based Structural Equation Modeling (PLS-SEM) with the help of SmartPLS to test the direct and indirect effects between variables. Evaluation of the measurement model was carried out through outer loading, Average Variance Extracted (AVE), Composite Reliability, and Cronbach's Alpha, while the structural model was evaluated through path coefficients, t-statistics, p-values, R-squares, and indirect effects to test the mediating role of tax compliance. Significance testing was conducted through a bootstrapping procedure. Given the limited number of observations of 24 and the data is at the aggregate regional level, the results of this study are interpreted cautiously and positioned as exploratory empirical evidence regarding the relationship between tax incentives, tax compliance, and the performance of micro-enterprises in DKI Jakarta.

3. RESULTS AND DISCUSSION

The evaluation of the research model was conducted in two stages: the evaluation of the measurement model (outer model) and the evaluation of the structural model (inner model). The measurement model was evaluated using outer loading, Average Variance Extracted (AVE), Composite Reliability, and Cronbach's Alpha. Furthermore, the structural model was evaluated using path coefficients, t-statistics, p-values, R-squared, and indirect effects to test the mediating role of tax compliance in the relationship between tax incentives and micro-enterprise performance.

Table 1. Outer loading results

Construct	Indicator	Outer Loading	Information
Tax Incentive (X)	X1 Receives Service	0,8919	Valid
Tax Incentive (X)	X2 Receives BPP	0,9625	Valid
Tax Incentive (X)	X3 Government BPP	0,9834	Valid
Tax Compliance (Z)	Z1 Has Certificate	0,9342	Valid
Tax Compliance (Z)	Z2 Formal Agreement	0,9342	Valid
Micro Enterprise Performance (Y)	Y1 Total IMK	0,9557	Valid
Micro Enterprise Performance (Y)	Y2 Profitable Partnership	0,8315	Valid
Micro Enterprise Performance (Y)	Y3 Share IMK Percentage	0,9446	Valid

Based on Table 1, all indicators have outer loading values above 0.70, with a range of 0.8315–0.9834. These values indicate that all indicators meet convergent validity at the indicator level and are able to adequately represent their respective constructs. The indicator with the highest loading is X3 Government BPP at 0.9834, while the lowest loading is Y2 Profitable Partnership at 0.8315; both still meet the validity criteria.

Table 2. Average Variance Extracted (AVE)

Construct	AVE	Criteria	Information
Tax Incentive (X)	0,8963	> 0,50	Fulfil
Tax Compliance (Z)	0,8728	> 0,50	Fulfil
Micro Enterprise Performance (Y)	0,8323	> 0,50	Fulfil

Based on Table 2, all constructs have an AVE value above 0.50. Tax Incentives obtained an AVE of 0.8963, Tax Compliance of 0.8728, and Micro Enterprise Performance of 0.8323. These results indicate that each construct is able to explain more than 50% of the variance of its indicator, thus all constructs meet the criteria for convergent validity.

Table 3. Composite Reliability

Construct	Composite Reliability	Criteria	Information
Tax Incentive (X)	0,9628	> 0,70	Reliable
Tax Compliance (Z)	0,9321	> 0,70	Reliable
Micro Enterprise Performance (Y)	0,9369	> 0,70	Reliable

Based on Table 3, the Composite Reliability values for all constructs are above 0.70, namely 0.9628 for Tax Incentives, 0.9321 for Tax Compliance, and 0.9369 for Micro-Enterprise Performance. Thus, all constructs demonstrate good internal consistency and are deemed reliable.

Table 4. Cronbach's Alpha

Construct	Cronbach's Alpha	Criteria	Information
Tax Incentive (X)	0,9412	> 0,70	Reliable
Tax Compliance (Z)	0,8543	> 0,70	Reliable
Micro Enterprise Performance (Y)	0,8970	> 0,70	Reliable

Table 5. R-Square Value

Endogenous Variables	R-Square	Explained Variance	Interpretation
Tax Compliance (Z)	0,3288	32,88%	Tax incentives explain some of the variation in tax compliance
Micro Enterprise Performance (Y)	0,7686	76,86%	Tax incentives and tax compliance explain most of the variation in micro-firm performance

Based on Table 5, the R-square value of Tax Compliance of 0.3288 indicates that Tax Incentives are able to explain 32.88% of the variation in Tax Compliance, while the remaining 67.12% is related to other factors outside the research model. Furthermore, the R-square value of Micro Enterprise Performance of 0.7686 indicates that Tax Incentives and Tax Compliance together are able to explain 76.86% of the variation in Micro Enterprise Performance, while the remaining 23.14% is related to other factors outside the model. Thus, the model's explanatory power is higher for the Micro Enterprise Performance construct than for Tax Compliance.

Table 6. Results of Hypothesis Testing and Mediation Effects

Hypothesis	Path of Influence	Types of Influence	Coefficient	t-statistic	p-value	Results
H1	Tax Incentives → Micro Enterprise Performance	Direct	-0,2239	1,7476	0,0951	Rejected
H2	Tax Incentives → Tax Compliance	Direct	0,5734	3,2830	0,0034	Accepted
H3	Tax Compliance → Micro Enterprise Performance	Direct	0,9857	7,6926	< 0,001	Accepted
H4	Tax Incentives → Tax	Indirect/Mediation	0,5652	3,7042	0,0002	Accepted

	Compliance → Micro Enterprise Performance					

The research results show that tax incentives do not have a significant direct impact on the performance of micro-enterprises. This finding suggests that the presence of incentives does not automatically improve business performance if their benefits are not accompanied by the ability of business actors to understand, access, and utilize them effectively. This finding differs from Afandi et al. (2023), who found a link between tax incentives and MSME performance, but also reinforces the view that the influence of fiscal policy can occur through intermediary mechanisms, not solely through direct channels.

Tax incentives have been shown to have a positive and significant impact on tax compliance. This finding suggests that the perceived benefits and convenience of tax policies can encourage more orderly engagement of business actors in the formal system. These results align with Sumiok (2023), who demonstrated the link between tax policy and MSME compliance and support the Theory of Planned Behavior perspective, which suggests that compliance behavior can be influenced by attitudes toward policy benefits and perceived control over the ability to fulfill tax obligations.

Tax compliance has also been shown to have a positive and significant impact on micro-enterprise performance. These results indicate that compliance not only represents the fulfillment of administrative obligations but also relates to orderly business management, reduced risk of sanctions, and stronger involvement in the formal business ecosystem. These findings are relevant to Saptono et al. (2024), who emphasized the important relationship between compliance, tax incentives, innovation, and sustainability of MSMEs. Thus, tax compliance can be understood as part of business governance that supports the achievement of micro-enterprise performance.

The main findings of this study indicate that tax compliance significantly mediates the effect of tax incentives on micro-enterprise performance. This pattern suggests that the effectiveness of tax incentives primarily occurs through increased compliance, rather than through a direct effect on performance. This finding complements Afandi et al. (2023), who found a mediating mechanism through innovation, and Saptono et al. (2024), who demonstrated a link between tax incentives and creative compliance and sustainability of MSMEs. This study's contribution lies in confirming that tax compliance is a crucial connecting mechanism between incentive policies and micro-enterprise performance.

4. CONCLUSION

This study concludes that tax incentives do not have a significant direct effect on micro-enterprise performance, but they do have a positive and significant effect on tax compliance. Tax compliance is further proven to have a positive and significant effect on micro-enterprise performance and significantly mediates the effect of tax incentives on micro-enterprise performance. These findings confirm that the effectiveness of tax incentives primarily operates through the tax compliance mechanism. Thus, tax compliance is a key variable explaining how incentive policies can translate into improved micro-enterprise performance.

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