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The Impact of Financial Literacy on Tax Compliance in Indonesia with a Focus on the 12% Tax Rate

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Abstract

This paper examines the impact of financial literacy on tax compliance in Indonesia, particularly focusing on the upcoming increase in Value Added Tax (VAT) to 12% scheduled for 2024. As a developing nation with a substantial population, Indonesia faces challenges in increasing state revenue through taxation. Financial literacy, defined as the ability to understand and effectively manage financial concepts, plays a vital role in enhancing tax compliance among the populace. The study highlights that individuals with higher financial literacy are more likely to comprehend the importance of paying taxes, understand their rights and obligations as taxpayers, and accurately calculate their tax liabilities. Conversely, those with lower financial literacy levels often struggle to grasp tax regulations and may be less compliant. The findings underscore that boosting financial literacy among the Indonesian population could lead to improved tax compliance, which is essential for increasing government revenue and promoting economic growth. Furthermore, this research highlights the importance of educational programs that aim to enhance financial literacy, thereby fostering a culture of compliance. A qualitative approach was adopted, involving literature reviews and thematic analyses to explore taxpayer perceptions, attitudes, and behaviors regarding the 12% VAT increase. Ultimately, the success of tax policy initiatives in Indonesia depends on the level of financial literacy within the community.

Keywords: Financial literacy, tax compliance, Value Added Tax, Indonesia, taxpayer perceptions, economic growth, education

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Introduction

Indonesia, as a developing country with a large population, continues to strive to increase state revenues through taxes. One of the efforts made is to increase public awareness of the importance of paying taxes and improve tax compliance. The increase in the Value Added Tax (VAT) rate to 12% in 2024 is one of the government's trend setters to help increase taxes, especially for luxury goods (Mateus & Mateus, 2021). However, the success of this policy is highly dependent on the level of financial literacy of the community. The low level of financial literacy is an important concern because it is very important for economic growth (Shamim & Agarwala, 2024). Financial literacy allows individuals to make the right financial decisions, which can lead to increased involvement with formal financial institutions, such as banks, and better financial planning and budgeting (Astuti & Trinugroho, 2016; Damayanti et al., 2023). In addition, financial literacy is essential to driving financial inclusion, which is necessary for the stability and growth of a country's economy as a whole (Santoso et al., 2016).

Financial literacy will also significantly affect various financial behaviors, including tax compliance (Shamim & Agarwala, 2024; Zaimovic et al., 2023). Individuals with high financial literacy tend to better understand the importance of paying taxes, know their rights and obligations as taxpayers, and can calculate taxes independently. Conversely, individuals with low financial literacy tend to have less understanding of taxes and find it more difficult to comply with their tax obligations. This is supported by previous research showing that a higher level of financial literacy can lead to better understanding and compliance with tax regulations (Moučková & Vítek, 2018; Wibowo et al., 2025). For example, tax literacy, a part of financial literacy, is essential for understanding tax obligations and benefits, which can increase voluntary tax compliance among individuals and businesses (Agusti & Rahman, 2023; Wibowo et al., 2025). Trust in tax authorities and perceptions of fairness of the tax system also play an important role in encouraging tax compliance (Wibowo et al., 2025).

The 12% increase in VAT rates has significant implications for tax compliance. On the one hand, an increase in tax rates can encourage people to be more compliant because awareness of the consequences of not paying taxes will increase (Laurin et al., 2023). However, on the other hand, an increase in tax rates can also trigger negative reactions from the public, such as efforts to avoid or reduce tax payments. Previous studies have shown a positive relationship between financial literacy and tax compliance. Individuals with higher financial literacy tend to be more compliant in paying taxes (Laurin et al., 2023). This is because they have a better understanding of the tax system, the benefits of paying taxes, and the consequences of tax avoidance (Tambunan, 2021).

The focus on the 12% tax rate further reinforces the importance of financial literacy (Adesina et al., 2023; Sharma, 2022). This increase in VAT rates requires a better understanding of the public about tax calculations and their impact on daily expenses. Without adequate financial literacy, the public will have difficulty adjusting to this change in tax policy. Therefore, in this study, researchers will examine the impact of financial literacy on tax compliance in Indonesia, especially in the context of the 12% VAT rate increase. Not only that, but this study also examines how financial literacy affects taxpayers' understanding and compliance with tax regulations. This is very relevant to the current issue. This study is expected to contribute to the development of more effective tax policies and increase public awareness of the importance of paying taxes. In addition, the results of this study can also be a reference for the government and other stakeholders in designing more targeted financial literacy improvement programs.

Financial Literacy

Financial literacy examines individuals' understanding and being skilled in allocating their finances to make appropriate and effective financial decisions. Financial literacy includes an understanding of financial instruments, financial theory, and the ability to apply this knowledge effectively (Finke & Huston, 2014). Financial literacy is essential for personal financial management, as it influences behaviors such as saving, investing, and managing debt. There is also a significant gap in financial literacy globally, with many individuals, particularly those lacking the skills necessary to manage their finances effectively (BANSAL, 2022; Bansal & Singh, 2023).

Financial literacy has many aspects that involve various components, such as money management, risk management, and investment strategies (Sharma, 2022; Sharma et al., 1981). Financial literacy also includes understanding financial concepts such as budgeting, credit, debt, savings, and investment (Murarka & Oates, 2020). Effective financial literacy education and knowledge must cover these areas comprehensively to ensure that individuals can make the right financial decisions. In addition, financial literacy is also associated with positive financial investment outcomes, such as better asset accumulation and better credit choices (Finke & Huston, 2014).

On the other hand, tax literacy is also an important aspect of financial literacy. Tax literacy is also very crucial because it can directly affect financial decision-making and the wealth of each individual. The importance of individuals in understanding the tax system can affect investment strategies and help individuals optimize their tax benefits (Chardon et al., 2016). For example, knowledge of tax-deductible savings plans can help individuals manage their tax obligations more effectively (Chardon et al., 2016; Laurin et al., 2023). However, on the other hand, there is often a gap between individuals' beliefs about their tax knowledge and their actual understanding, which can affect their financial decisions (Chardon et al., 2016).

Not only that, but there are also challenges in educating individuals effectively in financial literacy. Financial literacy education programs have shown very mixed results. Several studies have questioned their effectiveness in educating individuals in financial literacy (Finke & Huston, 2014; Huston, 2010). In addition, the methods used to measure financial literacy are also inconsistent, making it very difficult to assess the true impact of these programs. In addition, financial literacy education also needs to be tailored to different demographics to address specific needs and barriers (Guðjónsson et al., 2022; Patil et al., 2024).

Based on the description, it is very necessary to improve financial literacy to improve individual financial literacy, so it is necessary to suggest early education related to financial literacy, ideally starting in elementary school, to build a strong foundation (Guðjónsson et al., 2022; Patil et al., 2024). The financial education program provided must also be comprehensive and cover all aspects of personal finance, including taxation. Simplified disclosure and high default can also help individuals make better financial decisions. In addition, targeted education and counseling programs are expected to address the specific needs of various groups, such as freelancers or salaried employees, to improve their financial literacy and decision-making abilities(Sahoo et al., 2024)

Financial literacy is also very important to help improve economic stability and personal financial well-being. This also includes understanding various financial principles and concepts. Tax literacy is also an important component in helping to understand financial literacy. Although there are challenges in financial literacy education, targeted and comprehensive programs can significantly improve an individual's financial knowledge and decision-making skills. Early education and tailored programs are essential to bridge the financial literacy gap and empower individuals to achieve their financial goals.

Value Added Tax 12% Tax Rate and Its Implications

Tax rate increases, such as the Value Added Tax (VAT) in Indonesia to 12%, are a topic of interest to economists and policymakers. The implications of this policy are not only limited to increasing state revenues, but also extend to various aspects of the economy, including consumer behavior, production, and investment. Several economic theories can be used to analyze the impact of this tax increase.

Laffer Theory

The Laffer Theory was developed by economist Arthur Laffer. This theory describes the relationship between tax rates and tax revenues (Wanniski, 1978). The Laffer Curve shows that increasing tax rates does not always increase tax revenues. At a certain point, increasing tax rates can actually decrease tax revenues because it can reduce the incentive for people to work and invest. The Laffer Curve, popularized by American economist Arthur Laffer, describes the relationship between tax rates and tax revenues by the government. The shape of this curve resembles an inverted bell, with the horizontal axis showing tax rates and the vertical axis showing tax revenues (Lin & Jia, 2019; Wanniski, 1978).

Laffer's theory explains that tax rates that are too low will not produce optimal tax revenue (Lin & Jia, 2019; Wanniski, 1978). If the tax rate is 0%, there is clearly no tax revenue. Likewise, if the tax rate is very low, tax revenue will also be low. In addition, this theory also explains that increasing tax rates to a certain point will increase tax revenue. The government can increase tax revenue by increasing tax rates. Because with a higher tax rate, each transaction is subject to a higher tax. However, on the other hand, increasing tax rates beyond a certain point will actually reduce tax revenue. If the tax rate is too high, people will lose their incentive to work, invest, and carry out other economic activities. They may look for ways to avoid taxes, such as by embezzling income or making transactions on the black market. As a result, tax revenue will actually decrease.

The increase in VAT to 12% in Indonesia is an interesting policy to analyze using the Laffer Curve. The government aims to increase state revenue through this tax rate increase. However, it is important to remember that an increase in tax rates is not always directly proportional to an increase in tax revenue. Several factors need to be considered in this 12% VAT increase, such as: 1) **Elasticity of Demand;** If demand for goods and services subject to VAT is elastic (i.e., a small change in price leads to a large change in quantity demanded), an increase in the VAT rate may cause a decrease in consumption. As a result, overall VAT revenue may not increase, and may even decrease; 2) **Taxpayer Behavior:** Tax rate increases can affect taxpayer behavior. If taxpayers feel that tax rates are too high, they may look for ways to avoid or reduce their tax payments. This can reduce overall tax revenue; 3) **Economic Conditions:** Economic conditions also affect the effectiveness of tax increases. If the economy is sluggish, tax increases can actually make the situation worse by further suppressing consumption and investment.

The 12% VAT increase in Indonesia has the potential to increase state revenue. However, the government needs to be careful and consider various factors, including demand elasticity, taxpayer behavior, and economic conditions. Careful and comprehensive analysis is needed to ensure that this policy is truly effective in increasing state revenue without sacrificing economic growth.

Keynesian Theory

Keynesian theory is also relevant in this context. Keynesian theory, proposed by British economist John Maynard Keynes, emphasizes the importance of the government's role in regulating the economy. This theory emerged in response to the Great Depression in the 1930s, when free markets failed to revive the economy (Tanzi, 2018). This theory emphasizes the importance of the government's role in regulating the economy through fiscal policy, including tax policy (Skott & Ryoo, 2017; Tanzi, 2018). Tax increases can be used as one way to increase state revenues and finance government spending. However, the government also needs to consider its impact on aggregate demand and economic growth.

This theory examines several things, namely 1) Aggregate demand, which examines how the level of output and employment of a country is determined by aggregate demand, namely the total demand for goods and services in the economy. 2) The role of the government is where the government can influence aggregate demand through fiscal and monetary policies. Fiscal policy includes government spending and taxation, while monetary policy includes regulating interest rates and the amount of money in circulation (Nilsson, 2018; Skott & Ryoo, 2017). In a recession or slow economic growth situation, the government can increase spending (for example, for infrastructure or social programs) or lower taxes to encourage aggregate demand. Conversely, in an inflationary situation, the government can reduce spending or raise taxes to curb aggregate demand. (Nilsson, 2018; Skott & Ryoo, 2017).

In other aspects, the government also needs to consider the impact of the increase in VAT on aggregate demand and economic growth, as the increase in VAT can reduce people's purchasing power because the price of goods and services becomes more expensive. This can lead to a decrease in consumption, which is an important component of aggregate demand. Not only that, but the increase in VAT can also affect investment. If entrepreneurs feel that the increase in VAT will reduce demand for their products, they may delay or reduce investment (Laurin et al., 2023). In addition, decreased consumption and investment can hurt economic growth. If aggregate demand falls, companies will reduce production and may even lay off employees. This can lead to a decrease in national income and an increase in unemployment.

Methodology

This study uses a qualitative approach to explore the impact of financial literacy on tax compliance in Indonesia, especially with a focus on the 12% tax rate (Sugiyono, 2012). This approach is used to gain in-depth insight into taxpayer perceptions, attitudes, and behavior. Data collection was carried out by conducting a literature review related to the understanding of financial literacy and its implications for the 12% VAT increase (Sugiyono, 2012, 2018). This data review is used to understand their level of financial literacy and their views on the 12% tax rate increase from various sources. Qualitative data will be analyzed using thematic analysis to identify patterns and draw meaningful conclusions about the relationship between financial literacy and tax compliance.

Result and Discussion

Financial literacy is an individual's ability to understand and manage finances effectively (Kirana & Havidz, 2020; Murarka & Oates, 2020). This includes an understanding of basic financial concepts such as income, expenses, savings, investments, and taxes . Meanwhile, tax awareness refers to an individual's understanding of the importance of paying taxes, their rights and obligations as taxpayers, and the consequences of tax avoidance (Moučková & Vítek, 2018).

Financial literacy has a close relationship with tax awareness (Cechovsky, 2018). Individuals who have good financial literacy tend to have higher tax awareness (Cechovsky, 2018; Mahadevan et al., 2017). This is because they understand how the tax system works, how taxes contribute to the development of the country, and how their financial decisions can impact tax obligations.

Individuals with high levels of financial literacy tend to have a better understanding of the importance of paying taxes. This awareness is important because it helps them recognize the role of taxes in supporting public services and infrastructure. Individuals with high levels of financial literacy have a better understanding of basic financial concepts, such as income, expenses, savings, investments, and of course, taxes. This comprehensive understanding allows them to see the bigger picture of how the financial system works, including the role of taxes in it. (A. , Nichita et al., 2019; Wibowo et al., 2025).

On the other hand, financially literate tax behavior is also more proactive in fulfilling their tax obligations. This includes reporting income and paying taxes on time, which is often the result of their understanding of the tax system and the consequences of non-compliance (Agusti & Rahman, 2023; A. Nichita et al., 2019). Individuals with high levels of financial literacy tend to exhibit more proactive tax behavior. This means that they do not only passively fulfill their tax obligations, but also actively seek information related to tax regulations, calculate the taxes owed, and make tax payments on time. This proactive behavior is the result of a deep understanding of the tax system and an awareness of the importance of the role of taxes in national development.

Not only that, a deep understanding of the tax system and tax avoidance considerations encourages compliance. Financial literacy equips individuals with the knowledge needed to navigate tax regulations effectively, reducing the likelihood of unintentional non-compliance (Agusti & Rahman, 2023; Chardon et al., 2016; A. Nichita et al., 2019). A deep understanding of the tax system is key to improving tax compliance. Financial literacy equips individuals with the knowledge and skills needed to navigate the complex tax system, make smart financial decisions, and meet their tax obligations. Thus, financial literacy not only benefits individuals, but also contributes to increased state revenue and national development.

Voluntary compliance with tax obligations is also very important for the sustainability of a country's development. One of the key factors that drives voluntary compliance is public trust in the tax authorities and the perceived legitimacy of tax regulations. Trust in the tax authorities and the perceived legitimacy of tax regulations play a significant role in voluntary compliance. Financial literacy enhances this trust by making the tax system more comprehensive and less intimidating (Agusti & Rahman, 2023; Chardon et al., 2016; A. Nichita et al., 2019).

There are several recognized reasons for targeted educational interventions to improve tax literacy. Studies have shown that incorporating tax education into broader financial literacy programs can significantly improve compliance rates (Gonidakis et al., 2023; Moučková & Vítek, 2018; Trawule et al., 2022). Targeted educational interventions are key to improving tax literacy and ultimately tax compliance. By providing a comprehensive understanding of the tax system, we can build public awareness of the importance of paying taxes and encourage proactive tax behavior.

Keynesian Theory and Tax Compliance

Keynesian theory emphasizes the role of government in regulating the economy through fiscal policy, including tax policy (Nilsson, 2018; Tanzi, 2018). Increasing tax rates such as 12% VAT is one of the fiscal policy instruments used by the government to increase state revenue. This approach is based on the belief that government intervention can stabilize economic fluctuations and encourage full employment.

Keynesian economics argues that fiscal policy, including government spending and taxation, is essential to managing aggregate demand and achieving full employment. This is especially relevant during economic downturns when private sector demand is inadequate (Dewi Anggadini et al., 2022; Inasius, 2019; Skott & Ryoo, 2017). On the other hand, increased government spending can also increase aggregate demand. This can encourage companies to increase production and create new jobs. Not only that, lowering taxes will increase people's purchasing power, so they will consume more goods and services. This increased consumption will also drive economic growth.

In this regard, Keynesian theory provides a useful framework for understanding the role of government in managing the economy, especially in recessionary conditions. Appropriate fiscal policies, such as increasing government spending and lowering taxes, can help stimulate economic growth and reduce the negative impacts of a recession. However, it is important to remember that the implementation of fiscal policy must be done carefully and take into account the specific economic conditions.

Not only that, in this theory it will also correlate to aggregate demand which can also increase its taxes in this case on the implementation of 12% VAT which can be a tool for the government to increase revenue. However, the impact on aggregate demand can vary. While higher taxes can reduce disposable income and consumption in the short term, the revenue generated can be used for public investment that stimulates economic activity (Asimakopoulos et al., 2021; Booth, 1983; Siwinska & Bujak, 2006).

Keynesian theory states that government spending has a multiplier effect on the economy. For example, public investment funded by increased tax revenues can lead to higher aggregate demand and economic growth. This is because government spending can stimulate additional private spending, thereby reinforcing the initial fiscal intervention (Asimakopoulos et al., 2021; Boubaker et al., 2022; Cwik & Wieland, 2011). On the other hand, while Keynesian fiscal policy is effective in certain contexts, it faces criticisms and alternatives. For example, the Ricardian Equivalence Theorem states that the combination of taxes and debt does not affect aggregate demand, challenging the effectiveness of fiscal policy in stimulating the economy (Siwinska & Bujak, 2006).

The application of Keynesian fiscal policy has evolved over time. Initially, it was widely adopted to combat economic downturns, but its popularity waned in the late 20th century. However, the financial crisis of 2007–2008 led to a revival of interest in Keynesian fiscal interventions. (Nilsson, 2018; Tanzi, 2018).Thus, it can be concluded that Keynesian theory supports the use of fiscal policy, including tax measures such as a 12% VAT, to regulate the economy and promote stability. The effectiveness of such policies depends on their implementation and the broader economic context.

Laffer Theory and VAT 12% Tax Increase

Laffer's theory describes the relationship between tax rates and tax revenues. According to this theory, there is an optimal point at which tax revenues will be maximized. If tax rates are too high, individuals and companies will tend to avoid taxes, so that tax revenues will actually decrease. Laffer's theory states that initially, an increase in tax rates will lead to an increase in tax revenues. However, after reaching a certain point, further increases in tax rates will result in a decrease in tax revenues due to reduced economic activity and increased tax evasion.(Lin & Jia, 2019; Wanniski, 1978)

The increase in VAT to 12% in Indonesia can be studied through the lens of Laffer's Theory. If this increase encourages individuals and companies to reduce economic activity, such as reducing consumption or avoiding taxes, then tax revenues could actually decrease. Conversely, if the increase in VAT can increase tax efficiency and expand the tax base, then state revenues can increase (Safitra & Djamaluddin, 2019; Semenova, 2020).

Factors Influencing the 12% Tax Increase

Based on the explanation in this theory, it can be concluded that several factors influence tax compliance by 12%, including:

Financial Literacy Level: The higher the financial literacy of the community, the greater their awareness of the importance of paying taxes and the consequences of tax avoidance. Higher financial literacy significantly affects individual financial behavior, including tax compliance. Studies show that individuals with better financial knowledge tend to better understand the importance of paying taxes and the consequences of tax avoidance (A. Nichita et al., 2019). Not only that, but tax literacy also becomes additional specific knowledge about the tax system is also very important. This includes understanding tax-related issues, but keeping up to date with current developments, and managing personal budgets efficiently while considering tax payments (Cechovsky, 2018). Better tax literacy leads to better tax compliance because individuals understand the implications of tax avoidance (Chardon et al., 2016; A. Nichita et al., 2019). In addition, financial literacy can also be done through education and training to improve tax compliance. For example, targeted financial training can help individuals better understand tax concepts, thereby encouraging voluntary compliance (Neuberger et al., 2022).

Perception of Justice: When people perceive that the tax system is fair and transparent, they tend to be more compliant. Perceptions of fairness in the tax system, including distributive (fair distribution of the tax burden) and procedural (fair process in tax administration), are important in encouraging tax compliance. Studies show that when taxpayers perceive the tax system to be fair, they are more likely to comply voluntarily (Farrar et al., 2021; Kogler et al., 2015). The quality of treatment from tax authorities also plays an important role. Positive interactions with tax officials can increase compliance, although this effect may be reduced if taxpayers perceive a high likelihood of an audit (Farrar et al., 2021). In addition, perceived legitimacy of the tax authority mediates the relationship between fairness and compliance. Trust in the authority and belief in the legitimacy of the tax system encourage taxpayers to comply (Farrar et al., 2021; Gilligan & Richardson, 2005; Kogler et al., 2015).

Income Level: Taxpayers with high income tend to be more compliant than taxpayers with low income. The relationship between income level and tax compliance is a complex and multifaceted issue. Based on the abstract provided, in addition, previous research shows that taxpayers with higher incomes tend to be more compliant than those with lower incomes. (Muehlbacher & Kirchler, 2008).One study suggests that the effort invested in earning income can affect compliance. High effort in earning income increases compliance, suggesting that individuals who work harder to earn their income are more likely to comply with tax regulations (Kogler et al., 2015; Muehlbacher & Kirchler, 2008). This could imply that high-income individuals, who often invest significant effort in their work, may demonstrate higher compliance.

Conclusion

Based on the description, it can be concluded that this study supports previous findings that there is a positive relationship between financial literacy and tax compliance. Individuals with higher levels of financial literacy tend to have a better understanding of the tax system, are more aware of the importance of paying taxes, and are more proactive in fulfilling their tax obligations. In addition, the 12% increase in the VAT rate is a challenge for taxpayers. However, individuals with good financial literacy tend to be better prepared for this change. They can calculate the impact of the increase in tax rates on their personal finances, and are more proactive in seeking information and solutions to fulfill their tax obligations. Not only that, individuals who have good financial literacy tend to have more confidence in the tax system. They understand that the taxes they pay are used to finance various public services that benefit the community. This trust encourages them to be more compliant in paying taxes.

Although financial literacy plays a very important role, there are still many challenges to be faced, such as the complexity of the tax system, lack of socialization, and limited access to tax information. To improve tax compliance, various other efforts need to be made, such as improving financial literacy programs, simplifying the tax system, and improving the quality of tax services.

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