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The Impact of VAT Rate Increases, Tax Literacy, and Financial Literacy on Potential Value Added Tax Revenue

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ABSTRACT

This study aims to examine the effect of the increase Value Added Tax (VAT) rates, tax literacy, and financial literacy on potential VAT reveue. This study uses a quantitative approach with primary data obtained through the distribution of questionnaires to 101 Micro, Small, and Medium Enterprises (MSMEs) in Kalisongo Village, Malang Regency. The sampling technique was purposive using the Slovin formula. Data analysis was performed using multiple linear regression using IBM SPSS Statistic 26 software. The results show that the increase in VAT rates and financial literacy have a significant effect on potential VAT revenue. However, tax literacy does not have a significant effect partially.Simultaneously, these three variables have a significant effect on potential VAT revenue. This finding demonstrates the importance of improving financial literacy and evaluating VAT rate policies in efforts to optimize state revenue.

Keywords: Tax Literacy, VAT Rate Increase, VAT Revenue Potential

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1. INTRODUCTION

Tax revenue is the main source of state income which plays an important role in funding national development. One type of tax that makes a significant contribution is Value Added Tax (VAT), which is levied on the consumption of goods and service. However, VAT revenue often falls short of established targets, necessitating strategies to optimize this tax revenue potential (Kementrian Keuangan RI, 2022).

The policy of increasing the VAT rate from 10% to 11% since April 2022, and the planned increase to 12% in 2025, is a strategic step by the government to increase revenue. However, this policy may impose additional burdens on businesses, particulary Micro, Small, and Medium Enterprises (MSMEs), which are a dominant sector in the Indonesia economy. Although MSMEs contribute more than 60% to Gross Domestict Product (GDP), their contribution to tax revenue is relatively small (Kemenkop UKM RI, 2023).

Value Added Tax (VAT) revenue is strongly influenced by fiscal policies, taxpayers' knowledge, and financial capability. An increase in the VAT rate theoretically raises government revenue, yet its effectiveness depends on the compliance and financial resilience of taxpayers (Ebrill, L., Keen, M., Bodin, J. P., & Summers, 2001;OECD, 2020). Tax literacy, as an individual's understanding of tax rights and obligations, plays a crucial role in shaping voluntary compliance (Saad, 2014). Similarly, financial literacy enhances taxpayers' ability to manage business finances, prepare accurate records, and fulfill tax obligations effectively (Lusardi, A., & Mitchell, 2014). Thus, VAT rate increases, tax literacy, and financial literacy are interrelated factors that may determine the potential VAT revenue of a country.

Several previous studies have shown inconsistent results regarding the influence of these three variables on VAT revenue. For example, (Ilham, 2024) study found that VAT rate increases and tax literacy had significant effects, while financial literacy did not. Conversely, Islami A, (2023)concluded that only financial literacy significantly influenced potential VAT revenue.

Based on this background, this study aims to fill the gap in the literature by simultaneously and partially testing the effect of VAT rate increases, tax literacy, and financial literacy on potential VAT revenue, especially among MSMEs.

2. LITERATURE REVIEW

Value Added Tax

Value Added Tax (VAT) is an indirect tax imposed on the consymption of taxable goods and/or services within Indonesia. This tax is levied on end consumers and collected by businesses acting as tax collectors (Kementrian Keuangan RI, 2022) . Within the national tax structure, VAT contributes approximately 33–35% of total state tax revenue, making it the second-largest tax after Income Tax (BPS, 2023).

The VAT rate increase policy is stated in Law No. 7 of 2021 concerning Harmonization of Tax Regulations (HPP Law), which states that the VAT rate will increase from 10% to 11% starting April 1, 2022, and is planned to increase again to 12% on January 1, 2025. According to Sustiyo, A., & Hidayat, (2020) , this rate increase can theoretically increase tax revenue, but its implementation needs to consider the impact on business actors and public consumption.

Tax Literacy

Tax literacy is the knowledge, understanding, and skills of taxpayers in recognizing and properly exercising their tax rights and obligations (Ilham R, 2023) . Tax literacy encompasses not only technical aspects such as tax calculations but also reflects an awareness of voluntary compliance. In the context of MSMEs, tax literacy is crucial because the majority of business actors in this sector do not fully understand tax regulations (Saharani, N., & Sari, 2023).

Previous research shows that tax literacy is related to the level of compliance and potential tax revenue. Kusuma D, (2020) found that taxpayers with high levels of tax literacy are more likely to report and pay taxes correctly, thus supporting the achievement of revenue targets.

Financial Literacy

Financial literacy is defined as an individual's ability to understand basic financial concepts and the skills to manage finances effectively, including making decisions regarding debt, savings, and investments (Otoritas Jasa Keuangan, 2022). For MSMEs, financial literacy includes the ability to prepare simple financial reports, manage cash flow, and systematically record business transactions.

According to Arianti, A., & Azzahra, (2020) , good financial literacy supports operational efficiency and strengthens business actors' ability to fulfill tax obligations. Risti D, (2022) also emphasized that financial literacy contributes to increased tax compliance through orderly and transparent financial management.

Potential VAT Revenue

Potential tax revenue is an estimate of the amount of tax a country could theoretically collect if all taxpayers comply and the tax system operates optimally (Kurniawan, R., & Handayani, 2020). In the case of VAT, potential revenue is determined by consumption levels, taxpayer compliance, collection effectiveness, and tariff policies. Maximizing this potential can reduce the country's dependence on debt or other financing sources.

Ilham's (2024) research shows that VAT rate increases and tax literacy partially significantly influence potential VAT revenue, while financial literacy does not. Conversely, Islami A, (2023) research shows that only financial literacy has a significant effect. This inconsistency highlights the importance of conducting further research that considers all three variables simultaneously within a single analytical model.

To strengthen the theoretical foundation, this study adopts Agency Theory as the grand theory to analyze the relationship between government and MSMEs in the context of VAT collection. According to Jensen, M. C., & Meckling, (1976), Agency Theory explains the contractual relationship between a principal and an agent, where the principal (government) mandates the agent (MSMEs) to act in its interest in this case, to collect and remit VAT. However, conflicts of interest and information asymmetry often arise: the government aims to maximize tax revenue, while MSMEs may seek to minimize tax burdens due to limited tax knowledge, financial management skills, or administrative capacity Ross, (1973), In this regard, tax literacy and financial literacy act as crucial mechanisms to reduce agency costs by aligning the goals of both parties. Thus, Agency Theory provides a useful lens for analyzing how VAT rate increases, tax literacy, and financial literacy jointly affect the potential for VAT revenue.

Based on the theoretical description and previous research findings, it can be concluded that the increase in VAT rates, tax literacy, and financial literacy are important factors that are thought to influence the potential for VAT revenue, especially in the context of MSMEs. However, previous research has shown inconsistent influences between these variables on tax revenue, necessitating further study to provide stronger empirical evidence. Therefore, this study is designed to answer the following research questions:

a. Does the increase in VAT rates affect the potential for Value Added Tax (VAT) revenue?
b. Does tax literacy affect potential VAT revenue?
c. Does financial literacy affect potential VAT revenue?
d. Do increases in VAT rates, tax literacy, and financial literacy simultaneously affect potential VAT revenue?

3. METHODOLOGY

This study uses a quantitative approach with a causal associative approach, aiming to determine the influence of independent variables on the dependent variable. The research location was Kalisongo Village, Dau District, Malang Regency, chosen because it has a high concentration of Micro, Small, and Medium Enterprises (MSMEs) but low tax literacy (Lestari, P., Indrawati, NK, & Nurbatin, 2023) .

The population in this study is all active MSME actors in Kalisongo Village. The sample determination was carried out using the purposive sampling method, namely selecting respondents who met the criteria as MSMEs that had been running a business for at least one year and had a Business Identification Number (NIB). The number of samples was determined using the Slovin formula, resulting in 101 respondents.

The type of data used is primary data, namely data obtained directly from respondents through distributing questionnaires. The data collection technique was carried out using a closed survey method using a questionnaire based on a Likert scale of 1–5 to measure respondents' perceptions of the variables studied.

The operational definitions of the variables in this study are as follows:

a. The increase in VAT rates (X_1) is measured based on respondents' perceptions of the impact of changes in VAT rates on their business activities, including increased business expenses and adjustments to selling prices.
b. Tax Literacy (X_2) is measured through respondents' understanding of the rules, obligations, and benefits of paying taxes, especially VAT.
c. Financial Literacy (X_3) includes respondents' ability to manage business finances such as recording, budgeting, and cash control.
d. VAT Revenue Potential (Y) is measured based on respondents' perceptions of the relationship between their business activities and the potential contribution to VAT tax revenue.

Before the analysis was conducted, the research instruments were tested for validity and reliability. Validity testing was performed using a correlation value (r) > 0.30 , and reliability testing using a Cronbach's Alpha value > 0.70.

The data analysis technique used was multiple linear regression to determine the effect of variables X_1, X_2, and X_3 on Y, both partially and simultaneously. Prior to the regression test, classical assumption tests were conducted, including tests for normality, multicollinearity, and heteroscedasticity. The analysis was carried out with the help of IBM SPSS Statistics software version 26.

4. RESULTS

Descriptive Analysis Results

Descriptive analysis results indicate that the majority of respondents are MSMEs with a business history of more than three years and an annual turnover of less than IDR 500 million. A questionnaire distributed to 101 respondents revealed that the average tax and financial literacy scores were in the moderate category, while responses to the VAT rate increase showed a negative trend, particularly regarding business burdens and decreased consumer purchasing power.

VAT Rate Increase (X_1)
The results show that most respondents expressed "agree" or "strongly agree" with statements concerning the burden of the VAT rate increase on business operations. Many respondents indicated that the 11% VAT rate has led to higher operating costs and required price adjustments. Furthermore, some respondents noted a decline in consumer purchasing power, which indirectly affected sales turnover. These findings suggest that MSMEs in Kalisongo Village generally perceive the VAT rate increase as an additional business burden that may reduce competitiveness, even though the policy is designed to increase government revenue.

Tax Literacy (X_2)
The analysis of tax literacy indicates that respondents' answers were more varied. On basic questions about recognizing VAT obligations, most respondents chose "agree," showing that they have at least a general awareness of VAT. However, on more technical aspects, such as calculating VAT or understanding detailed regulations, a significant number of respondents selected "neutral" or even "disagree." This finding highlights that while MSMEs are aware of the existence of VAT obligations, their depth of understanding is still limited, which may explain why tax literacy does not significantly influence VAT revenue potential in the regression analysis.

Financial Literacy (X_3)
Responses related to financial literacy showed predominantly positive trends. On the item regarding the ability to record business transactions, the majority of respondents selected "strongly agree" or "agree." This suggests that MSMEs in Kalisongo Village are generally capable of keeping basic financial records. Likewise, for questions concerning budgeting and cash flow management, most responses indicated agreement, demonstrating that respondents have developed practical financial management skills. These results confirm that financial literacy among MSMEs is relatively good, enabling them to better fulfill their tax obligations.

VAT Revenue Potential (Y)
On the dependent variable, VAT revenue potential, respondents generally "agree" that their business activities contribute to potential VAT revenue. Most respondents also acknowledged that higher sales volumes and consistent business growth would increase their tax contribution. However, a portion of respondents expressed concern that administrative complexity and weak purchasing power could reduce their effective contribution. This indicates that while the potential for VAT revenue exists, it is highly dependent on business stability and government efforts to simplify the tax system.

Validity and Reliability Test
All items in the questionnaire showed an item-total correlation value of >0.30 , indicating validity. Reliability testing using Cronbach's Alpha showed a value of >0.70 for all variables, thus the instrument was considered reliable for use in measurement.

Classical Assumption Test
Based on the results of the Kolmogorov-Smirnov normality test, the data is normally distributed. No multicollinearity was found (VIF < 10), and the results of the heteroscedasticity test showed no particular pattern in the scatterplot graph, which indicates that the classical assumptions are met.

Results of Multiple Linear Regression Analysis
Based on the multiple linear regression test, the following equation was obtained:

$$Y = 4.126 + 0.385X_1 + 0.085X_2 + 0.268X_3$$

Where:
X_1 : Increase in VAT rates
X_2 : Tax literacy
X_3 : Financial literacy
Y : Potential VAT revenue

The results of the t-test show that:

a. The increase in VAT rates (X_1) has a significant positive effect on potential VAT revenue ($p < 0.05$) .
b. Tax literacy (X_2) does not have a significant partial effect ($p > 0.05$) .
c. Financial literacy (X_3) has a significant effect on potential VAT revenue ($p < 0.05$) .

The results of the F test show that simultaneously the three independent variables have a significant effect on the potential for VAT revenue (F count = 8.529; $p < 0.05$) , with a coefficient of determination (R^2) value of 0.208. This means that 20.8 % of the variation in potential VAT revenue can be explained by these three variables.

5. DISCUSSION

The result of this study confirm that the VAT rate increase policy has a direct impact on increasing potential VAT revenue. This supports Keynesian fiscal theory that increasing consumption tax rates can increase state revenue, although it must be balanced with protecting public purchasing power (Sustiyo, A., & Hidayat, 2020) .

Meanwhile, tax literacy did not significantly impact potential VAT revenue. This indicates that understanding tax regulations is insufficient to encourage active participation by MSMEs in the tax system, possibly due to low motivation, procedural complexity, or the lack of technological support (Kusuma D, 2020).

This is in contrast to financial literacy, which has been shown to have a significant positive effect. This finding supports research by Risti D (2022) and Arianti, A., & Azzahra (2020) , which states that business actors' ability to record and manage finances is correlated with compliance with tax obligations, including calculating and remitting VAT.

Simultaneously, the results of this study confirm that the three variables complement each other in influencing the potential for VAT revenue. Therefore, fiscal policy should not only focus on tariff regulation, but also on more extensive financial and tax education for MSMEs.

6. CONCLUSION

This study aims to examine the effect of the increase in Value Added Tax (VAT) rates, tax literacy, and financial literacy on the potential VAT revenue of MSMEs in Kalisongo Village, Malang Regency. Based on the data analysis, the following conclusions were drawn:

a. The increase in the VAT rate has a significant positive impact on potential VAT revenue. This indicates that the rate increase policy directly impacts the potential tax contribution from the MSME sector.
b. Tax literacy does not significantly impact potential VAT revenue. This indicates that understanding tax obligations does not fully encourage active participation among MSMEs in fulfilling their tax obligations.
c. Financial literacy has a significant positive impact on potential VAT revenue. This means that MSMEs with good financial management are better able to fulfill their tax obligations promptly and accurately.

Simultaneously, the increase in VAT rates, tax literacy, and financial literacy have a significant impact on potential VAT revenue. These three variables support each other in explaining the contribution of MSMEs to state revenue through the VAT mechanism.

Based on the findings and conclusions outlined, this research offers several practical implications that stakeholders, including government, business actors, and academics, can consider. Therefore, the following are some suggestions as a follow-up to the research findings:

a. For the government , especially the Directorate General of Taxes, it is recommended to not only focus on tariff policies, but also increase tax literacy through educational programs that are easily accessible to MSMEs, both online and offline.
b. For MSMEs , it is important to improve competency in financial recording and management so that they can be better prepared to face tax obligations, as well as take advantage of available tax incentives or assistance programs.
c. For further researchers , it is recommended to expand the scope of the region and consider other variables such as tax compliance, financial digitalization, or the use of e-invoices in measuring the potential tax revenue from the MSME sector.

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