

## **How Does Financial Literacy Mediate the Relationship Between Tax Knowledge, Ethnicity Issue, and Trust in Government on Tax Compliance?**

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### **ABSTRACT**

This study investigates the determinants of tax compliance by integrating cognitive, socio-cultural, and institutional factors within a unified analytical framework. Specifically, it examines the direct effects of tax knowledge, ethnicity issue, and trust in government on tax compliance, as well as the mediating role of financial literacy. Using a quantitative research design, primary data were collected through online questionnaire administered to 359 respondents. The data were analyzed by Partial Least Squares-Structural Equation Modeling (PLS-SEM). The findings indicate that tax knowledge and ethnicity issue significantly and positively influence tax compliance, whereas trust in government does not show a significant effect. Moreover, financial literacy significantly mediates the relationship between tax knowledge and tax compliance but fails to mediate the effects of ethnicity issue and trust in government. These findings suggest that financial literacy operates as a selective mediator, primarily translating knowledge into compliant behavior through cognitive pathways, while socio-cultural and institutional factors influence compliance through alternative normative mechanisms. This study contributes by proposing a nuanced behavioral model that differentiates competence-based and perception-based drivers of tax compliance, offering important implications for multidimensional tax policy design in developing and multicultural contexts.

## **INTRODUCTION**

Taxation constitutes a fundamental pillar of modern states, serving as the primary mechanism through which governments finance public expenditures, redistribute income, and regulate economic activity (Lymer & Oats, 2009). Beyond its fiscal function, taxation is increasingly recognized as a policy instrument for achieving broader socio-economic objectives, including reducing inequality, stimulating economic growth, and shaping social behavior through targeted fiscal measures such as excise taxes. Despite its centrality, ensuring sustained tax compliance remains a persistent and complex challenge, particularly in developing and multicultural societies where institutional capacity, social norms, and economic literacy vary substantially.

A long-standing stream of tax compliance literature has emphasized both coercive and voluntary determinants of compliance behavior. While traditional models highlight enforcement mechanisms such as audits and penalties as primary drivers, more recent perspectives underscore the



importance of psychological, cognitive, and socio-cultural factors in shaping taxpayer behavior (Kirchler et al., 2008; Martinez-Vazquez & Torgler, 2009). Empirical evidence suggests that compliance is influenced by a diverse set of factors, including demographic characteristics, perceived fairness, education, tax knowledge, moral obligation, and trust in authorities (Bobek et al., 2018; Hidayati et al., 2023; Kirchler, 2007; Youde & Lim, 2019). However, despite the growing recognition of these determinants, the literature remains fragmented in explaining how these factors interact within complex social contexts, particularly in ethnically diverse societies.

One critical yet underexplored dimension is the role of ethnicity and social identity in shaping tax compliance (Hidayati et al., 2023). Existing studies provide mixed evidence: while some research demonstrates that ethnic background influences compliance through cultural norms, trust, and collective identity (Chan et al., 2000; Kasipillai & Jabbar, 2006), other studies find no significant relationship, particularly in emerging economies (Prihatiningtyas et al., 2021). This inconsistency suggests that the effect of ethnicity may not be direct, but contingent upon other mechanisms that remain insufficiently theorized and empirically tested. At the same time, financial literacy has emerged as a key determinant of economic behavior, enabling individuals to better understand financial obligations and make informed decisions. Yet, its role in tax compliance research is often treated as a direct predictor, with limited attention to its potential as a mediating mechanism linking cognitive and socio-institutional factors to compliance behavior.

This study addresses these gaps by proposing an integrated framework that examines the interplay between Tax Knowledge, Ethnicity Issue, Trust in Government, and Tax Compliance, with Financial Literacy positioned as a mediating variable. The novelty of this research lies in two key aspects. First, it advances the tax compliance literature by reconceptualizing financial literacy as a selective mediator that operates within the cognitive domain, rather than as a universal explanatory mechanism across all determinants. Second, it situates tax compliance within a multicultural context, specifically Indonesia, thereby extending existing theories by incorporating socio-cultural heterogeneity as a central analytical dimension.

Indonesia provides a compelling empirical setting due to its high reliance on tax revenue for national development and its pronounced ethnic diversity. As tax compliance remains suboptimal despite ongoing fiscal reforms, understanding the behavioral and contextual drivers of compliance becomes increasingly critical. By empirically testing both direct and indirect relationships among the proposed variables, this study aims to 1) examine the effects of Tax Knowledge, Ethnicity Issue, and Trust in Government on Tax Compliance, and 2) investigate the mediating role of Financial Literacy in these relationships.

## **LITERATURE REVIEW**

### **Tax Compliance (TC)**

Tax compliance is generally conceptualized as the extent to which taxpayers adhere to prevailing tax laws and regulations. It reflects not only formal conformity with statutory requirements but also the degree of voluntary willingness to fulfill tax obligations as an outcome of accumulated knowledge and competencies related to taxation (Palil & Akir, 2013). In this regard, tax compliance is often viewed as a behavioral manifestation of individuals' readiness to contribute to public finance through tax payments under normal circumstances (Zhang et al., 2016). Prior literature emphasizes that tax knowledge and awareness constitute foundational precursors to compliance behavior, as individuals who understand tax rules and their implications are more likely to act in accordance with them.

Additionally, perceptions of fairness in the tax system play a critical role in shaping compliance attitudes, as perceived inequities may weaken individuals' willingness to comply voluntarily.

From a broader conceptual perspective, tax compliance can be interpreted through multiple lenses. James & Alley (2009) argue that compliance should not merely be understood as mechanical adherence to legal requirements, but rather as a willingness of individuals and entities to act in accordance with both the letter and the spirit of tax law, even in the absence of enforcement measures. This perspective aligns with contemporary views that distinguish between enforced compliance and voluntary compliance. Expanding on this, McBarnet (2001), identifies three distinct forms of compliance behavior: committed compliance, capitulative compliance, and creative compliance. Committed compliance refers to a genuine willingness of taxpayers to fulfill their obligations without resistance, reflecting internalized norms and moral alignment with the tax system. Capitulative compliance, in contrast, denotes reluctant adherence driven primarily by external pressures such as audits or penalties. Meanwhile, creative compliance captures strategic behavior whereby taxpayers exploit legal ambiguities to minimize tax liabilities while remaining formally within the boundaries of the law. Taken together, these perspectives highlight that tax compliance is a multidimensional construct encompassing cognitive, behavioral, and normative elements. Understanding these dimensions is essential for developing more comprehensive models of taxpayer behavior, particularly in complex socio-economic and institutional contexts.

### **Tax Knowledge (TK)**

Tax knowledge refers to the extent to which individuals understand tax regulations, procedures, and broader financial concepts related to taxation. It encompasses both general awareness of tax obligations and more specific knowledge regarding the application of tax rules in practice. A higher level of tax knowledge is widely recognized as a critical determinant of taxpayer behavior, as it shapes individuals' preferences, attitudes, and ultimately their compliance decisions (Albab & Suwardi, 2021). In this sense, tax knowledge functions not merely as an informational resource but as a cognitive foundation that enables taxpayers to interpret and respond to fiscal policies effectively.

Early conceptualizations by Harris (1989), distinguish between two dimensions of tax knowledge: general knowledge acquired through formal education and everyday exposure, and specific knowledge related to tax planning opportunities, including potential avenues for tax avoidance. The former emphasizes the role of educational attainment in enhancing taxpayers' understanding of tax laws and regulations, while the latter reflects a more strategic dimension, where individuals utilize their knowledge to optimize tax outcomes within legal boundaries. This distinction highlights that tax knowledge may have dual implications facilitating both compliance and strategic behavior depending on how it is applied.

Empirical evidence consistently demonstrates that tax knowledge is closely associated with taxpayers' ability to comprehend tax legislation and fulfill their obligations accordingly (Singh, 2003). Furthermore, Palil & Akir (2013) argue that knowledge of tax laws is a key predictor of tax attitudes, influencing how individuals perceive fairness, complexity, and legitimacy within the tax system. Despite its importance, relatively few studies have explicitly examined how specific forms of tax knowledge shape attitudinal and behavioral responses to taxation. Nonetheless, existing literature suggests that enhanced fiscal knowledge is positively correlated with more favorable tax attitudes and improved compliance behavior, as individuals with greater understanding are better equipped to navigate tax systems and align their actions with regulatory expectations.

## **Ethnicity Issue (EI)**

Indonesia represents one of the most ethnically diverse countries in the world, with more than one thousand ethnic and sub-ethnic groups identified in national census data. However, this study focuses on major ethnic groups with substantial population representation, namely Javanese, Sundanese, Batak, Madurese, and Betawi. Demographic evidence indicates that the Javanese constitute the largest ethnic group, widely distributed across the archipelago but predominantly concentrated in Central Java, East Java, and Yogyakarta. The Sundanese represent the second-largest group, primarily residing in West Java, followed by the Batak population concentrated in North Sumatra. The Madurese, originating from Madura Island, are also widely dispersed across Indonesia, while the Betawi population is primarily located in the Greater Jakarta area, including Jakarta, Bogor, Depok, Tangerang, and Bekasi (Ananta et al, 2005).

Beyond demographic distribution, ethnicity plays a significant role in shaping social, political, and economic behavior. (Aspinall et al, 2011) argue that ethnic identity influences collective action and political engagement, which may extend to individual and household decision-making processes. In the Indonesian context, ethnicity is also associated with the formation of social norms and stereotypes that may affect perceptions of public policies, including taxation (Goebel, 2013). These socio-cultural dynamics suggest that ethnicity is not merely a demographic characteristic but a salient factor that may shape individuals' attitudes, trust, and behavioral responses toward government institutions.

In the context of tax compliance, ethnicity may influence how individuals perceive tax obligations, fairness, and government legitimacy. Prior research indicates that culturally tailored tax education programs can enhance tax awareness and compliance among ethnically diverse populations (Hidayati et al., 2023). This suggests that aligning tax communication strategies with ethnic characteristics and cultural values may improve engagement and foster voluntary compliance. Consequently, ethnicity represents a critical yet underexplored dimension in tax compliance research, particularly in multicultural societies such as Indonesia, where socio-cultural heterogeneity may significantly affect the effectiveness of fiscal policy interventions.

## **Trust in Government (TiG)**

Trust in government is a multidimensional construct encompassing both institutional and interpersonal dimensions, reflecting citizens' confidence in public institutions as well as their experiences with public officials (Kumlin, 2002; Kumlin & Rothstein, 2005; Rothstein, 2001; Rothstein & Stolle, 2003). This trust is largely shaped by individuals' accumulated experiences and knowledge, particularly in relation to the quality and delivery of public services. In this context, trust can be understood as an evaluative outcome of citizens' satisfaction with public service performance, which includes both process-related attributes (e.g., accessibility, fairness, transparency, and responsiveness) and outcome-related attributes (e.g., effectiveness and service delivery results) (Bouckaert & Van de Walle, 2003; Bouckaert & Van de Walle, 2001).

Prior studies suggest that positive service experiences tend to reinforce trust in government, as individuals develop favorable perceptions based on repeated interactions with public institutions (Kumlin, 2002; Rothstein & Stolle, 2003). However, the relative importance of service processes versus outcomes varies across individuals. While some citizens prioritize tangible outcomes, others place greater value on procedural fairness, accessibility, and the professionalism of service providers. This heterogeneity reflects differences in expectations, needs, and normative orientations toward

public services, making it difficult to establish a universal standard for evaluating service quality and its impact on trust (Aberbach & Rockman, 2000).

Moreover, the influence of public services on trust is context-dependent and varies across cultural and institutional settings. Certain services may carry greater symbolic or practical significance in shaping trust, depending on societal priorities and governance structures (Christensen & Lægheid, 2005; Pollitt, 2001). For example, in some contexts, interactions with tax authorities may play a more critical role in shaping trust compared to other public services. Additionally, the level of government responsible for service delivery whether local, regional, or central may influence trust formation. Localized service provision can enhance familiarity and perceived accountability, thereby strengthening trust; however, it may also generate social pressures or stigmatization in tightly knit communities, potentially undermining satisfaction and trust (Christensen & Lægheid, 2005).

Finally, trust in government is also influenced by broader governance paradigms, particularly the increasing emphasis on citizens as service consumers. From a neoliberal perspective, this shift highlights individual interests and service efficiency, whereas from a democratic perspective, it enhances citizen engagement and accountability in government-citizen relationships (Self, 2000). Importantly, trust is not static but evolves over time, with short-term experiences shaping specific trust evaluations, while long-term interactions contribute to generalized or diffuse trust in government institutions. Taken together, these perspectives suggest that trust in government is a complex and dynamic construct that plays a crucial role in shaping citizens' attitudes and behavioral responses, including compliance-related decisions.

### **Financial Literacy (FL)**

Financial literacy is widely defined as the ability to utilize financial knowledge and skills to effectively manage financial resources in order to achieve long-term financial well-being (Huston, 2010). It represents a multidimensional construct that extends beyond mere knowledge, encompassing cognitive understanding, practical skills, behavioral application, and experiential learning in financial decision-making (Hung et al., 2011). In this regard, financial literacy integrates both the capacity to comprehend financial concepts and the ability to apply such knowledge in real-life contexts, ultimately shaping individuals' financial behavior and outcomes.

Importantly, prior research indicates that financial literacy is not necessarily aligned with formal educational attainment. Lusardi & Mitchell (2011) demonstrate that individuals with higher levels of education do not always exhibit adequate financial literacy, suggesting that formal education alone is insufficient to ensure financial competence. Instead, experiential factors such as workplace-based financial education and peer learning play a more substantial role in developing financial literacy. This highlights the importance of practical exposure and contextual learning in enhancing individuals' financial capabilities.

Furthermore, financial literacy is influenced by socio-demographic and contextual factors, including ethnicity, geographic location, and socio-economic environment. Evidence from cross-country studies shows significant disparities in financial literacy across population groups. For example, in the United States, White and Asian populations tend to demonstrate higher levels of financial literacy compared to African American and Hispanic groups, while regional disparities are also observed in countries such as Italy, Russia, and the Netherlands (Lusardi & Mitchell, 2011). These findings suggest that access to financial information, cultural context, and frequency of exposure to financial practices are critical determinants of financial literacy.

In addition, financial literacy has been consistently linked to individuals' financial decision-making and choice of financial alternatives. Individuals with higher levels of financial knowledge are more likely to make informed and prudent financial decisions, thereby reducing reliance on suboptimal or high-risk financial options (Birkenmaier & Fu, 2018; Lusardi & Tufano, 2015; Robb et al., 2015). Conversely, limited financial literacy is associated with a higher likelihood of experiencing financial distress and poor financial outcomes (Lusardi & Tufano, 2015). Individuals with inadequate financial literacy often face difficulties in evaluating financial products and aligning decisions with their long-term needs, which may ultimately undermine their financial stability (Birkenmaier & Fu, 2018). Collectively, these findings position financial literacy as a critical capability that not only shapes financial behavior but also influences broader economic and compliance-related decisions.

### Hypotheses Development

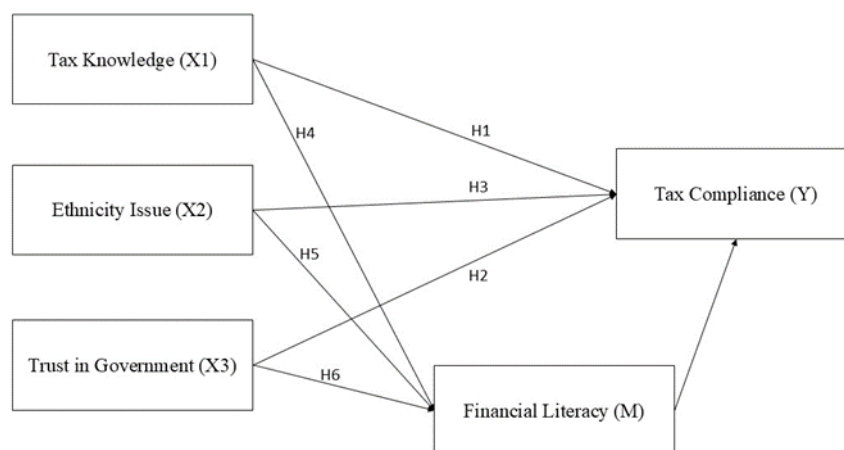
This study employs a research model that examines the relationships among tax knowledge, ethnicity issue, trust in government, financial literacy, and tax compliance. The model is designed to capture both the direct effects of tax knowledge ethnicity issue, and trust in government on tax compliance, as well as the potential mediating effects of financial literacy. From these variables, the hypothesis is formulated as follows:

- H1: Tax knowledge significantly affects tax compliance.
- H2: Ethnicity issue significantly affects tax compliance.
- H3: Trust in government significantly affects tax compliance.
- H4: Financial literacy mediates the relationship between tax knowledge and tax compliance.
- H5: Financial literacy mediates the relationship between ethnicity issue and tax compliance.
- H6: Financial literacy mediates the relationship between trust in government and tax compliance

## RESEARCH METHODS

### Research Design

This study adopted a quantitative research design to investigate the relationships among Tax Knowledge, Ethnicity Issue, Trust in Government, Financial Literacy, and Tax Compliance. Quantitative approaches are widely employed in behavioral and taxation research to examine causal relationships among latent constructs and to generate empirical evidence through statistical modeling (Ghozali & Latan, 2015).



**Figure 1. Research Framework**

Primary data were collected using a structured questionnaire administered through an online survey platform (Google Forms) (Kistyanto et al., 2022). The target population comprised individual taxpayers in Indonesia who had previously been exposed to tax-related education or information, either through formal education, tax seminars, training programs, or public tax socialization initiatives. This criterion was applied to ensure that respondents possessed a minimum level of familiarity with taxation concepts relevant to the study objectives.

The study employed a non-probability sampling technique, specifically convenience sampling. The questionnaire link was disseminated through multiple digital communication channels, including email, WhatsApp, and Instagram, enabling eligible respondents to voluntarily participate in the survey. This sampling approach was considered appropriate due to the absence of a comprehensive national sampling frame of taxpayers and the practical challenges associated with reaching geographically dispersed respondents across Indonesia. The target population consists of taxpayers in Indonesia, with eligibility criteria requiring respondents to have prior exposure to tax education, either through formal institutional learning, seminars, or training programs by using random sampling technique. This criterion was applied to ensure that participants possessed a minimum level of familiarity with taxation concepts relevant to the study, where this study uses 359 respondents (see table 1). Furthermore, online survey distribution has been widely recognized as an efficient and appropriate data collection strategy in contemporary behavioral and social science research, particularly for studies involving diverse populations and voluntary participation.

The use of a self-administered online questionnaire offered several methodological advantages, including wider geographical coverage, respondent anonymity, and reduced social desirability bias in responses related to tax behavior and financial capability. However, this study acknowledges several limitations associated with the sampling procedure. Since the survey relied on voluntary participation and convenience sampling, the findings may not fully represent the broader population of Indonesian taxpayers. In addition, the respondent profile was predominantly composed of high school graduates, which may influence the interpretation of financial literacy constructs and limit the generalizability of the findings across different educational groups. Nevertheless, the sample remains appropriate for examining the proposed behavioral relationships within the context of this study.

Participation in the survey was entirely voluntary, and respondents were informed that all responses would remain anonymous and confidential. No personally identifiable information was collected during the data collection process, thereby ensuring compliance with ethical standards for research involving human participants.

### **Indicators**

The questionnaire items were adapted from previously validated scales widely used in tax compliance and financial behavior research. The measurement of key constructs in this study draws upon prior empirical studies, including tax knowledge and tax compliance constructs adapted from (Mukhlis, Utomo, & Soesetio, 2015; Palil & Akir, 2013), ethnicity issue constructs from (Brown & Langer, 2010), trust in government constructs from (Christensen & Læg Reid, 2005), and financial literacy constructs based on (Huston, 2010; Lusardi & Tufano, 2015).

The adaptation process involved aligning the original measurement items with the research context and ensuring conceptual equivalence across constructs. Each indicator was carefully reviewed and refined to reflect the operational definitions employed in this study, while maintaining consistency with the theoretical foundations of the original scales. This approach enhances the

validity and comparability of the measurement model, as recommended in prior methodological literature. The final instrument consists of a set of structured items representing each construct, which were subsequently used for empirical testing within the proposed research framework.

**Tabel 1. Respondent Characteristics**

Characteristics		Participants	Total Participants
Gender	Women	224	359
	Men	135	
Employment	Civil Servants/Military/Police	28	359
	Employees (Private Sector, State-Owned Enterprises, etc.)	189	
	Entrepreneur	127	
	Unemployed	10	
Education	High Schools	287	359
	Diploma I/II/III	32	
	Diploma IV/Bachelor's Degree	29	
	Master/Doctor	11	
Ethnic	Javanese	97	359
	Madurese	90	
	Sundanese	99	
	Batak	61	
	Others	11	

Source: Processed Data

**Table 2. Research Instruments**

Variables	Construct	Sources
Tax Knowledge	Knowledge on responsibilities of tax	(Mukhlis et al., 2015; Palil & Akir, 2013; Youde & Lim, 2019)
	Knowledge on tax types	
	Knowledge on tax rates	
	Knowledge on tax mechanism	
	Knowledge on tax payment	
	Knowledge on tax measurement	
Ethnicity Issue	Primordialism	(Brown & Langer, 2010)
	Social Distance	
Trust in Government	Health service satisfaction	(Christensen & Lægheid, 2005)
	Government service satisfaction	
	Social service satisfaction	
Financial Literacy	Satisfaction with Democracy	(Huston, 2010; Lusardi & Tufano, 2015)
	Basic concept in time value money	
	Basic concept in economic condition	
	Borrowing concepts in using online loan	
	Saving/investing concepts in retirement savings	
Tax Compliance	Timeliness in delivering	(Mukhlis et al., 2015)
	Timeliness for tax payment	
	Obedience in tax payment	

Source: Processed Data

## **Data Analysis**

Data analysis in this study was conducted using Structural Equation Modeling (SEM) based on the Partial Least Squares (PLS) approach, which is particularly suitable for prediction-oriented research and complex models involving latent constructs (Rigdon, 2012). The analysis was performed using SmartPLS 3 software, a widely recognized tool for variance-based SEM applications (Schlagel & Sarstedt, 2016). The PLS-SEM framework comprises two primary components: the measurement model (outer model) and the structural model (inner model) (Ghozali & Latan, 2015).

The measurement model assesses the relationships between observed indicators and their corresponding latent constructs, ensuring that the constructs are measured reliably and validly. For reflective measurement models, evaluation criteria include convergent validity, assessed through outer loadings and Average Variance Extracted (AVE), as well as discriminant validity to ensure that constructs are empirically distinct. Reliability is evaluated using Composite Reliability (CR) and Cronbach's Alpha (CA), which indicate the internal consistency of the measurement items (Ghozali & Latan, 2015).

The structural model, on the other hand, examines the relationships among latent constructs and evaluates the model's predictive capabilities. Key assessment criteria include the coefficient of determination ( $R^2$ ) to measure the explained variance of endogenous constructs, and predictive relevance ( $Q^2$ ) to assess the model's out-of-sample predictive accuracy. Hypothesis testing is conducted a bootstrapping procedure to determine the statistical significance of path coefficients between constructs (Ghozali & Latan, 2015).

## **RESULTS AND DISCUSSION**

### **Measurement Model**

The results of the measurement model evaluation (outer model) indicate that all constructs meet the recommended reliability and validity thresholds (see Table 3). Specifically, the outer loadings of all indicators exceed the minimum acceptable threshold of 0.50, demonstrating adequate indicator reliability. In terms of internal consistency, Cronbach's Alpha (CA) values range from 0.700 to 0.907, while Composite Reliability (CR) values fall between 0.810 and 0.928, both exceeding the commonly accepted cutoff value of 0.70. These results confirm the reliability of the measurement scales used in this study.

Furthermore, convergent validity is established as the Average Variance Extracted (AVE) values for all constructs range from 0.517 to 0.806, surpassing the recommended threshold of 0.50. This indicates that each construct explains more than half of the variance of its indicators, thereby confirming that the indicators adequately represent their respective latent constructs. Overall, these findings demonstrate that the measurement model exhibits satisfactory levels of indicator reliability, internal consistency, and convergent validity, suggesting that the constructs are measured appropriately and are suitable for subsequent structural model analysis (Hair et al, 2020; Henseler et al., 2016).

In addition to reliability and validity assessments, multicollinearity diagnostics were conducted to ensure the robustness of the measurement model. The Variance Inflation Factor (VIF) values range from 1.270 to 3.137, which are well below the commonly accepted threshold of 10, indicating the absence of multicollinearity among the predictor constructs. These findings suggest that the indicators are not excessively correlated and that each construct contributes uniquely to the model estimation (Hair et al., 2020).

**Table 3. Measurement Model**

Variables	Loadings	VIF	AVE	CR	CA	Mean
Tax Knowledge			0.583	0.893	0.858	3.688
TK.1	0.628	1.276				4.242
TK.2	0.773	2.862				3.487
TK.3	0.791	3.137				3.362
TK.4	0.817	2.263				3.752
TK.5	0.815	1.896				3.952
TK.6	0.741	1.956				3.331
Ethnicity Issue			0.806	0.893	0.760	3.926
EI.1	0.887	1.601				3.974
EI.2	0.908	1.601				3.905
Trust in Government			0.763	0.928	0.907	4.248
TIG.1	0.849	2.385				4.217
TIG.2	0.924	3.020				4.206
TIG.3	0.924	3.195				4.236
TIG.4	0.791	2.636				4.334
Financial Literacy			0.517	0.810	0.700	4.282
FL.1	0.695	1.296				4.353
FL.2	0.804	1.368				4.403
FL.3	0.662	1.320				4.259
FL.4	0.706	1.270				4.114
Tax Compliance			0.801	0.924	0.876	4.020
TC.1	0.893	2.254				3.891
TC.2	0.902	2.457				4.013
TC.3	0.890	2.447				4.155

Source: Processed Data

**Tabel 4. R-square Score**

	R Square	R Square Adjusted
Financial Literacy	0.184	0.177
Tax Compliance	0.397	0.390

Source: Processed Data

### Structural Model

The structural model in this study was evaluated by examining the coefficient of determination ( $R^2$ ), which reflects the model's explanatory power for endogenous constructs. The results indicate that the  $R^2$  value for Tax Compliance is 0.390, suggesting that approximately 39.0% of the variance in Tax Compliance can be explained by the exogenous variables included in the model. According to established guidelines in PLS-SEM literature, this score can be interpreted as having moderate explanatory power (Hair et al., 2020). In addition, the mediating construct Financial Literacy exhibits an  $R^2$  value of 0.177, indicating that 17.7% of its variance is explained by the predictor variables in the model. While this score is relatively lower, it still reflects an acceptable level of explanatory capacity in behavioral research contexts, where multiple external factors may influence financial literacy (Hair et al., 2020).

Overall, these findings suggest that the proposed model demonstrates adequate predictive capability in explaining both Tax Compliance and Financial Literacy. The  $R^2$  values provide empirical support for the structural relationships specified in the model, indicating that the included

constructs contribute meaningfully to explaining variations in the endogenous variables. A detailed presentation of the R<sup>2</sup> values for each construct is provided in Table 4.

### Hypothesis Test

The evaluation of the structural model was further conducted by assessing the statistical significance of the hypothesized relationships a bootstrapping procedure, which is commonly employed in PLS-SEM to test the significance of path coefficients (Hair et al., 2019). Hypothesis testing was performed using t-statistics and p-values for both direct and indirect effects, with significance determined at the 5% level ( $t \geq 1.96$ ;  $p \leq 0.05$ ). The results of the hypothesis testing are summarized in Table 5. The findings reveal that Tax Knowledge has a positive and statistically significant effect on Tax Compliance ( $\beta = 0.409$ ,  $t = 6.722$ ,  $p < 0.001$ ), indicating that higher levels of tax knowledge are associated with increased compliance behavior. This result supports Hypothesis 1 (H1), confirming the importance of cognitive understanding in shaping taxpayers' compliance decisions.

Similarly, Ethnicity Issue demonstrates a positive and significant relationship with Tax Compliance ( $\beta = 0.123$ ,  $t = 2.625$ ,  $p = 0.009$ ), suggesting that socio-cultural factors play a meaningful role in influencing compliance behavior. Thus, Hypothesis 2 (H2) is supported. In contrast, Trust in Government does not exhibit a significant effect on Tax Compliance ( $\beta = -0.037$ ,  $t = 0.675$ ,  $p = 0.499$ ), indicating that variations in institutional trust do not directly translate into compliance behavior within the context of this study. Therefore, Hypothesis 3 (H3) is not supported.

With regard to indirect effects, the mediating role of Financial Literacy is found to be significant only in the relationship between Tax Knowledge and Tax Compliance ( $\beta = 0.005$ ,  $t = 2.451$ ,  $p = 0.014$ ), supporting Hypothesis 4 (H4). This finding suggests that financial literacy partially transmits the effect of tax knowledge on compliance behavior. However, the mediating effects of Financial Literacy in the relationships between Ethnicity Issue and Tax Compliance ( $\beta = 0.008$ ,  $t = 0.862$ ,  $p = 0.388$ ) and between Trust in Government and Tax Compliance ( $\beta = -0.001$ ,  $t = 0.130$ ,  $p = 0.897$ ) are not statistically significant. Consequently, Hypotheses 5 (H5) and 6 (H6) are rejected. Thus, these results highlight the differential roles of cognitive, socio-cultural, and institutional factors in shaping tax compliance, while also indicating that the mediating mechanism of financial literacy is selective rather than universal across all relationships.

**Tabel 5. Hypothesis Test**

Relationship	Coefficient	T-stats	p-value	Keputusan
Direct effect				
TK => TC	0.409	6.722	0.000	Accepted
EI => TC	0.123	2.625	0.009	Accepted
TIG => TC	-0.037	0.675	0.499	Rejected
Indirect effect				
TK => FL => TC	0.005	2.451	0.014	Accepted
EI => FL => TC	0.008	0.862	0.388	Rejected
TIG => FL => TC	-0.001	0.130	0.897	Rejected

Note(s): Level signifikan (5%); t-statistics  $\geq 1.96$ ; p-value  $\leq 0.05$

Source: Processed Data

## **Discussion**

### **Tax Knowledge on Tax Compliance**

The findings of this study provide robust evidence that Tax Knowledge exerts a positive and statistically significant effect on Tax Compliance, thereby supporting Hypothesis 1. This result is consistent with prior empirical studies conducted in both international and Indonesian contexts, which consistently identify tax knowledge as a key determinant of compliance behavior (Albab & Suwardi, 2021; Bernard et al., 2018; Hidayati et al., 2023; Hidayati et al., 2023; Mukhlis et al., 2015; Palil, 2010; Zulma, 2020). The positive coefficient observed in this study reinforces the argument that a higher level of understanding of tax systems enhances taxpayers' ability and willingness to comply with fiscal obligations.

From a theoretical perspective, this finding can be interpreted through the lens of the slippery slope framework, which posits that compliance behavior is shaped not only by enforcement mechanisms but also by taxpayers' cognitive and psychological capacities, including their understanding of tax regulations (Kirchler et al., 2008). In this regard, tax knowledge serves as a foundational cognitive resource that reduces uncertainty, enhances perceived fairness, and limits opportunities for rationalizing non-compliant behavior. Individuals with greater tax knowledge are better equipped to interpret tax rules, understand reporting procedures, and anticipate legal consequences, thereby fostering more compliant behavior.

The present findings are further supported by international empirical evidence demonstrating that tax education significantly improves compliance across diverse populations (Eriksen & Fallan, 1996; Hofmann et al., 2014; Park & Hyun, 2003). Recent studies also highlight that, particularly in developing economies, tax knowledge may outweigh traditional deterrence-based factors such as penalties and audits in influencing compliance decisions. For instance, evidence from MSMEs indicates that tax knowledge emerges as a dominant predictor of compliance compared to enforcement-related variables (Amalia, 2025). This suggests a paradigm shift from coercive to educative approaches in tax administration.

In the Indonesian context, these findings are further corroborated by recent local studies. Hidayati et al., (2023) demonstrate that tax knowledge significantly enhances individual taxpayer compliance, particularly supported by modern administrative systems and increased tax awareness. Similarly, research on MSMEs indicates that tax knowledge, in conjunction with awareness, plays a critical role in shaping compliance behavior (Intansari & Supramono, 2022). The convergence of these findings underscores the strategic importance of strengthening tax literacy as a means of improving compliance outcomes.

From a practical standpoint, the results imply that tax policy should not rely solely on deterrence mechanisms, such as sanctions and enforcement, but should also emphasize educational and capacity-building initiatives. Structured tax education programs such as targeted training for business owners, onboarding programs for new taxpayers, and continuous public outreach can serve as effective instruments to enhance voluntary compliance and broaden the tax base. Consequently, integrating tax knowledge development into fiscal policy frameworks represents a proactive and sustainable approach to improving tax compliance in the long term.

### **Ethnicity Issue on Tax Compliance**

The findings of this study indicate that Ethnicity Issue has a positive and statistically significant effect on Tax Compliance, thereby supporting Hypothesis 2. This result underscores the importance of socio-cultural factors in shaping taxpayer behavior and suggests that ethnicity-related dynamics

should be carefully considered in the design of tax policies and interventions. Prior research has emphasized that policy effectiveness is contingent upon its alignment with the socio-cultural context of the target population, including ethnic identity and group-specific values (Yong, 2014). In ethnically diverse societies, such as Indonesia, these dynamics become particularly salient, as individuals' attitudes toward taxation are often embedded within broader social identity frameworks.

From a theoretical standpoint, this finding can be explained Social Identity Theory, which posits that individuals' behavior is influenced by their identification with social groups and the norms associated with those groups. When individuals perceive their ethnic group as being fairly represented and treated within the broader institutional system, they are more likely to internalize collective norms that promote prosocial behavior, including tax compliance (Andriani & Bruno, 2022). Conversely, in contexts characterized by ethnic fragmentation, reduced trust in public institutions may weaken tax morale and lower compliance levels (Li, 2010). Thus, ethnicity operates as a critical channel through which perceptions of fairness, inclusion, and collective responsibility influence compliance behavior.

The empirical evidence supporting this relationship has been reinforced by recent international studies. For instance, Wyrwich & Fritsch (2023) demonstrate that social and ethnic heterogeneity influences tax morale through mechanisms such as perceived similarity, social cohesion, and distributive justice. Similarly, (Alabede et al., 2011; Hidayati et al., 2023; Kasipillai & Jabbar, 2006; Li, 2010; Prihatiningtyas et al., 2021) highlights that disparities in tax compliance across regions and groups are often rooted in differences in perceived fairness and social belonging. These findings suggest that ethnicity does not merely function as a demographic variable but represents a deeper socio-psychological construct that shapes compliance attitudes and behaviors. Furthermore, emerging evidence indicates that, when effectively managed, ethnic diversity can be transformed into social capital that strengthens collective engagement and compliance (Alabede et al., 2011; Hidayati et al., 2023; Kasipillai & Jabbar, 2006; Li, 2010; Prihatiningtyas et al., 2021).

In the Indonesian context, these findings align with prior local studies emphasizing the importance of culturally responsive approaches in tax education and policy implementation. Hidayati et al., (2023) demonstrate that tax education programs tailored to ethnic and cultural contexts significantly enhance taxpayer awareness and compliance. Likewise, Albab & Suwardi (2021) find that perceptions of fairness across ethnic groups contribute to higher levels of trust and compliance. These results highlight the need for tax authorities to adopt inclusive and culturally sensitive strategies in engaging diverse populations.

From a policy perspective, the findings suggest that ethnicity should not be viewed as a source of division but rather as a strategic resource for enhancing tax compliance. Policymakers are encouraged to design targeted interventions such as culturally adaptive tax education programs, inclusive communication campaigns, and community-based engagement initiatives that emphasize shared identity, collective progress, and equitable distribution of public benefits. By framing tax compliance as a collective contribution to national development that resonates across ethnic groups, governments can foster stronger social cohesion and improve voluntary compliance. Consequently, leveraging ethnic diversity as a form of social capital represents a promising pathway for strengthening tax systems in multicultural societies.

### **Trust in Government on Tax Compliance**

The findings indicate that Trust in Government does not have a significant effect on Tax Compliance. This finding contrasts with a substantial body of literature suggesting that trust in public institutions is a key determinant of tax compliance, primarily through its influence on perceived legitimacy,

fairness, and accountability of the fiscal system (Alm & Torgler, 2006; Martinez-Vazquez & Torgler, 2009). However, the present findings suggest that, in developing-country contexts, tax compliance may be driven more by formal obligations and enforcement mechanisms than by institutional trust. In such frameworks, higher levels of institutional trust are expected to foster voluntary compliance by strengthening taxpayers' moral commitment to contribute to public goods provision.

This finding supports the argument that taxpayers in transitional economies often adopt a compliance-by-obligation orientation rather than a compliance-by-trust approach (Adekoya et al., 2022). In such contexts, taxpayers may comply primarily due to legal requirements, administrative procedures, or fear of sanctions, rather than intrinsic trust in government institutions. Governance-related issues, including perceived inefficiency, limited transparency, and concerns regarding the equitable distribution of public resources, may further weaken the role of trust in shaping compliance behavior (Bahramov, 2023). Gaps between public expectations and the actual quality of government services, concerns regarding corruption, perceived inefficiencies in public spending, and limited transparency may weaken the role of trust as a driver of compliance. Under such conditions, taxpayers may adopt a pragmatic or instrumental approach to compliance, wherein tax payment is viewed as a compulsory obligation rather than a voluntary civic duty (Adekoya et al., 2022). This distinction reflects a shift from norm-based compliance to rule-based compliance, which has important implications for tax policy design.

From a policy standpoint, these findings imply that strategies aimed at enhancing tax compliance in multicultural and institutionally evolving settings such as Indonesia should not rely exclusively on strengthening trust in government. Instead, a more comprehensive approach is required, incorporating fair and consistent enforcement, simplification of tax administration, expansion of tax literacy, and increased visibility of the tangible benefits derived from tax revenues (perceived return on taxation). Such measures may facilitate a gradual transition from rule-based compliance toward trust-based compliance in the long term (Adekoya et al., 2022; OECD, 2022). Furthermore, improving fiscal governance, transparency, and public participation in budgetary processes may enhance the credibility of public institutions, thereby enabling trust to play a more substantive role in shaping tax compliance behavior in the future.

### **The Mediating Role of Financial Literacy: Tax Knowledge on Tax Compliance**

The findings demonstrate that Financial Literacy significantly mediates the relationship between Tax Knowledge and Tax Compliance, indicating that tax knowledge alone is insufficient to directly produce compliant behavior without adequate financial capability. This result suggests that taxpayers are more likely to comply when they not only understand tax regulations, but also possess the practical financial skills necessary to manage tax-related obligations effectively (Eriksen & Fallan, 1996; Kirchler et al., 2008).

From a theoretical perspective, the findings support the view that financial literacy functions as a behavioral mechanism that translates cognitive understanding into practical action (Hofmann et al., 2014; Lusardi & Mitchell, 2011). Tax knowledge provides individuals with an understanding of tax systems and procedures, while financial literacy enables them to apply that knowledge through budgeting, financial planning, and cash-flow management. Accordingly, financial capability becomes an important pathway linking tax knowledge to compliance behavior.

The findings are consistent with previous studies showing that integrated tax and financial literacy education contributes more effectively to voluntary compliance than technical tax education alone, particularly among MSMEs and informal-sector taxpayers (Albab & Suwardi, 2021; Hidayati

et al., 2023). From a policy perspective, the results imply that tax authorities should adopt a dual-pillar approach by simultaneously strengthening tax education and practical financial capability through targeted training programs, bookkeeping workshops, and financial management assistance. Theoretically, this finding reinforces the argument that financial literacy operates as a competence-based mediating mechanism within tax compliance behavior.

### **The Mediating Role of Financial Literacy: Ethnicity Issue on Tax Compliance**

The findings indicate that Financial Literacy does not significantly mediate the relationship between Ethnicity Issue and Tax Compliance. This result suggests that the influence of ethnicity on compliance behavior operates primarily through socio-cultural and identity-based mechanisms rather than through financial capability (Lusardi & Mitchell, 2011). In other words, perceptions of fairness, social belonging, and collective identity appear to play a more substantial role in shaping taxpayer behavior than individual financial competence.

From a theoretical perspective, this finding is consistent with Social Identity Theory, which emphasizes that individuals' behavior is strongly influenced by group affiliation and shared social norms (Andriani & Bruno, 2022). Ethnicity-related factors may therefore affect tax compliance through social cohesion, institutional inclusion, and perceived distributive fairness rather than through cognitive or technical financial skills. This finding also reinforces the distinction between competence-based pathways and identity-based pathways in explaining tax compliance behavior.

The findings align with previous studies showing that ethnic diversity and perceptions of social fairness influence tax morale independently of financial literacy levels (Alabede et al., 2011; Wyrwich & Fritsch, 2023). In the Indonesian context, culturally adaptive tax communication and inclusive public engagement remain important in strengthening voluntary compliance across diverse communities (Albab & Suwardi, 2021; Hidayati et al., 2023). Accordingly, improving financial literacy alone may not be sufficient to address compliance issues rooted in socio-cultural dynamics. Tax authorities should therefore complement educational programs with inclusive and culturally sensitive policy approaches that strengthen social trust, representation, and collective responsibility.

### **The Mediating Role of Financial Literacy: Trust in Government on Tax Compliance**

The findings indicate that Financial Literacy does not mediate the relationship between Trust in Government and Tax Compliance. This result suggests that the influence of institutional trust on taxpayer behavior operates primarily through affective and normative mechanisms rather than through financial capability or cognitive competence. In other words, taxpayers' trust in government is more closely associated with perceptions of fairness, legitimacy, and moral obligation than with technical financial skills.

From a theoretical perspective, this finding is consistent with the slippery slope framework, which conceptualizes trust as a determinant of voluntary compliance rooted in institutional legitimacy and psychological acceptance of authority (Hofmann et al., 2014; Kirchler et al., 2008). In contrast, financial literacy represents a competence-based construct associated with budgeting, financial planning, and procedural decision-making. The absence of a mediating effect therefore highlights that cognitive capability cannot substitute for institutional credibility in shaping trust-based compliance behavior.

The findings are supported by previous studies showing that the relationship between trust in government and tax compliance tends to remain independent of financial literacy levels, particularly in developing-country contexts characterized by governance challenges and limited institutional

confidence (Horodnic, 2018; Kumlin, 2002). In Indonesia, taxpayer compliance is often influenced more strongly by perceptions of transparency, accountability, and the effective use of public funds than by individual financial capability (Hidayati et al., 2023).

Accordingly, the findings imply that improving financial literacy alone is insufficient to strengthen trust-based compliance. Tax authorities should therefore prioritize institutional trust-building strategies, including improving transparency, strengthening public accountability, and increasing public awareness regarding the social benefits of taxation. Theoretically, this finding reinforces the distinction between competence-based pathways and affective institutional pathways in explaining tax compliance behavior.

### **Implication**

This study offers important theoretical contributions to the literature on tax compliance by advancing a more nuanced understanding of the mechanisms through which cognitive, individual, and socio-institutional factors interact in shaping compliance behavior. Specifically, the finding that Financial Literacy mediates the relationship between Tax Knowledge and Tax Compliance, while failing to mediate the effects of Trust in Government and Ethnicity Issue, provides empirical support for the distinction between cognitive and non-cognitive pathways in behavioral models. From a cognitive-behavioral perspective, financial literacy operates primarily as a knowledge-based capability that enables individuals to process, interpret, and apply tax-related information in decision-making contexts (Anaman et al., 2024; Gangodawilage et al., 2021; Rosdiana, 2020; Wiquar et al., 2022). This suggests that the effectiveness of tax knowledge in driving compliance is contingent upon individuals' financial competence, reinforcing the idea that knowledge must be operationalized through cognitive capacity to influence behavior.

This finding is further aligned with fiscal psychology theory, which posits that the behavioral impact of tax knowledge is strengthened if individuals possess the ability to internalize and apply such knowledge in practical financial contexts (Kirchler et al., 2008). In contrast, the non-significant mediating role of financial literacy in the relationships involving Trust in Government and Ethnicity Issue indicates that socio-institutional and identity-based factors exert their influence through alternative mechanisms (Horodnic, 2018; Lusardi & Tufano, 2015). These factors are more closely associated with affective and normative dimensions such as perceived legitimacy, social norms, and identity-based biases rather than cognitive capabilities (Albab & Suwardi, 2021; Bobek et al., 2018) (Alm et al., 2024; Khairunnisa & Hidayat, 2022; Albab & Suwardi, 2023).

Accordingly, this study contributes to the literature by proposing that financial literacy should not be conceptualized as a universal mediating construct, but rather as a selective mediator that operates specifically within competence-based pathways. In contrast, identity-driven and institutional trust mechanisms follow distinct behavioral routes that are less dependent on individuals' financial capabilities. This distinction enriches existing tax compliance models by integrating multiple behavioral dimensions cognitive, affective, and social into a more comprehensive explanatory framework.

From a practical perspective, the findings carry significant implications for policymakers, tax authorities, and fiscal education institutions. Given that financial literacy strengthens the effect of tax knowledge on compliance, policy interventions should prioritize the development of applied fiscal competencies rather than merely disseminating technical information. Practical and behaviorally informed educational initiatives such as tax filing simulations (e.g., e-filing systems), tailored training

modules for MSMEs, and financial management workshops are likely to enhance taxpayers' ability to translate knowledge into compliant behavior (OECD, 2024).

However, since financial literacy does not mediate the effects of trust in government and ethnic identity, strategies aimed at improving tax compliance cannot rely solely on technical education. Instead, governments must simultaneously strengthen institutional trust through enhanced transparency, accountability, and effective public communication regarding the use of tax revenues (Abramova et al., 2022; Anaman et al., 2024; Rahman, 2017; Waris & Murangwa, 2012). In multicultural contexts such as Indonesia, culturally sensitive and inclusive communication strategies are equally critical. Programs that incorporate local values, languages, and socio-cultural narratives can help reduce identity-based resistance and foster a stronger sense of collective responsibility toward taxation (Alabede et al., 2011; Hidayati et al., 2023; Kasipillai & Jabbar, 2006; Palil, 2010; Prihatiningtyas et al., 2021; Tae, Jonghee, Jae, & Lee, 2019)..

## CONCLUSION

This study provides empirical evidence on the multidimensional determinants of tax compliance by integrating cognitive, socio-cultural, and institutional perspectives within a unified analytical framework. The findings demonstrate that Tax Knowledge and Ethnicity Issue significantly enhance Tax Compliance, whereas Trust in Government does not exert a direct effect in this context. Furthermore, Financial Literacy is confirmed as a significant mediating mechanism only in the relationship between Tax Knowledge and Tax Compliance, while it fails to mediate the effects of Trust in Government and Ethnicity Issue. These results highlight that financial literacy operates as a selective mediator, primarily functioning within cognitive pathways that translate knowledge into behavior, rather than within affective or identity-based mechanisms. In contrast, socio-cultural and institutional factors such as ethnicity and trust shape compliance behavior through distinct normative and psychological channels that are not contingent upon financial capability. Theoretically, this study advances the tax compliance literature by disentangling the differential roles of cognitive competence, social identity, and institutional trust, thereby offering a more nuanced behavioral model that captures the complexity of compliance decisions in multicultural and developing country contexts. Practically, the findings underscore the necessity of adopting a multidimensional policy approach that simultaneously strengthens tax literacy, enhances institutional legitimacy, and incorporates culturally sensitive engagement strategies. Thus, this study contributes to a deeper understanding of how diverse behavioral mechanisms interact in shaping tax compliance and provides actionable insights for designing more effective, inclusive, and sustainable fiscal policies in complex socio-economic environments.

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