



## Understanding Gaps in Tax Regulation: Legal and Compliance Challenges among MSMEs

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### **Abstract**

Tax regulation is intended to provide clarity, fairness, and certainty in state revenue collection. However, for Micro, Small, and Medium Enterprises (MSMEs), a significant gap often exists between regulatory formulation and actual understanding at the operational level. This study explores how comprehension gaps regarding Government Regulation No. 7 of 2021 and Government Regulation No. 55 of 2022 affect legal certainty and voluntary tax compliance among MSME actors. Utilizing a qualitative approach with thematic analysis, data were collected through semi-structured interviews with eight MSME owners from diverse sectors in East Java, Indonesia. The findings reveal that limited awareness and fragmented understanding of tax obligations contribute to perceptions of injustice, confusion in tax filing procedures, and fear of administrative sanctions. These gaps not only undermine the effectiveness of tax policy but also erode trust in the legal system among MSME actors. The study highlights the urgent need for more accessible, targeted, and sector-specific tax education, as well as regulatory simplification to enhance justice and compliance.

**Keywords:** *MSMEs; Tax Regulation; Legal Certainty; Fiscal Justice; Tax Compliance*

### **Introduction**

Micro, Small, and Medium Enterprises (MSMEs) constitute a critical component of the Indonesian economy, particularly in their contribution to Gross Domestic Product (GDP), employment absorption, and the promotion of economic equity (Anita, 2020; Kaharuddin et al., 2024; Naradda Gamage et al., 2020). According to the Central Statistics Agency (BPS), MSMEs contribute over 60% to GDP and account for approximately 97% of national employment (Judijanto, 2024; Kartiko et al., 2023). Their proven resilience during national and global economic crises, such as the 1998 Asian financial crisis and the COVID-19 pandemic further underscores their strategic importance in maintaining macroeconomic stability (Sumampouw et al., 2021).

Despite this vital role, the interaction between MSMEs and the national taxation system remains problematic. Various regulatory reforms intended to enhance the institutional and legal capacity of MSMEs have not adequately resolved core issues related to tax compliance. The challenges extend beyond administrative capacity and touch upon a more fundamental concern: the difficulty MSME

owners face in understanding and complying with tax obligations that are often perceived as overly complex, opaque, and misaligned with the realities of small-scale business operations (Picas et al., 2021).

Taxation serves not only as a primary source of state revenue but also as a mechanism to promote equitable economic redistribution. However, in the MSME context, the effectiveness and fairness of the tax system are still contested (Rukundo, 2020). While tax contributions are intended to support public services and infrastructure development that benefit MSMEs, regulatory complexity and burdensome tax rates can hinder profitability and competitiveness, especially amid economic volatility and rising operational costs (Matthew et al., 2020; Rupeika-Apoga et al., 2022; Thukral, 2021).

In this regard, the government issued Government Regulation (PP) No. 7 of 2021 on the empowerment of cooperatives and MSMEs, and PP No. 55 of 2022 on income tax arrangements. These regulations introduced simplified mechanisms such as the 0.5% final income tax rate. Nevertheless, these provisions apply only to MSMEs with a maximum annual turnover of IDR 4.8 billion, excluding many enterprises that remain small in capacity but fall beyond the threshold. This regulatory cutoff has created a legal and fiscal gap, where MSMEs just above the threshold experience greater tax burdens than those classified as micro or small enterprises, despite facing similar economic challenges (Nurbekova et al., 2024; Rahmawati, 2024). This situation raises concerns about proportionality and justice within the tax regime and reflects a form of embedded structural inequality.

From a legal standpoint, such inconsistencies threaten the principle of legal certainty. Ambiguities in regulatory language, combined with varied interpretations by tax authorities, create confusion among MSME owners regarding their obligations, eligibility for tax relief, and reporting procedures. These uncertainties, in turn, reduce voluntary compliance and erode trust in the tax system. Perceptions of injustice and legal ambiguity have tangible consequences. When MSME owners view the tax system as arbitrary or disproportionately burdensome, they may disengage from formal systems or adopt avoidance strategies, undermining the effectiveness and legitimacy of fiscal policy.

To analyze these concerns, this study draws on John Rawls' theory of justice, particularly the principle that policy inequalities are justifiable only if they benefit the least advantaged. Since MSMEs constitute a vulnerable group within the economy, fiscal policies should be structured to support their sustainability and not reinforce systemic disadvantages (Rawls, 1971). While much of the discourse on tax reform emphasizes administrative efficiency and revenue optimization, its normative and experiential dimensions remain underexplored. Issues such as access to information, consistency in implementation, and fairness in classification criteria are central to the lived experiences of MSME owners and must be accounted for in regulatory design.

A review of existing literature shows a gap in empirical studies that address the subjective perceptions of MSME owners regarding regulatory implementation, particularly concerning PP No. 7/2021 and PP No. 55/2022. Most studies focus on doctrinal legal analysis or macroeconomic impact without considering how policies are experienced and interpreted on the ground. Perceptions play a crucial role in shaping tax compliance and the legitimacy of legal norms. A regulation that appears just in design may fail in execution if it lacks clarity or is not perceived as fair. Therefore, this study adopts an empirical-qualitative approach to explore how MSME owners perceive the implementation of PP No. 7/2021 and PP No. 55/2022, especially in terms of legal certainty and fairness in tax practices.

This research was conducted in East Java, one of Indonesia's most economically dynamic provinces and a region with a high concentration of MSMEs across various sectors. East Java presents a relevant case due to its diversity of business scales, active local tax administration, and the presence of both urban and rural MSME clusters. These characteristics make it a strategic region to capture the variety of perceptions and practical experiences of MSME owners in dealing with tax regulations.

By emphasizing the subjective and experiential dimension of fiscal policy, this study aims to offer fresh insights into how regulatory design is received at the grassroots level. The findings are expected to generate practical implications for improving tax policy responsiveness and contribute to the discourse on justice-oriented fiscal governance. By identifying gaps between regulatory intent and implementation outcomes, this study seeks to inform the formulation of more inclusive and equitable tax regulations in Indonesia.

### **The Concept of Tax Justice**

The concept of tax justice stems from broader legal justice principles, emphasizing the proportional distribution of burdens and benefits within society. From a distributive justice perspective, a fair tax system requires individuals to contribute based on their economic capacity, as articulated by Richard Musgrave through the ability to pay principle (Sumaryono, 2013). Accordingly, taxation functions not merely as a revenue-generating tool, but as a mechanism for promoting social equity and economic redistribution.

John Rawls, in his theory of justice as fairness, outlines two key principles: equal basic liberties for all and the difference principle, which allows inequality only if it benefits the least advantaged. Applied to taxation, Rawls supports progressive tax systems that go beyond revenue collection to create equitable access to essential services like education and healthcare (Rawls, 1971). This aligns with Amartya Sen's capability approach, which views justice in terms of real opportunities, suggesting that taxation should enhance citizens' abilities to live meaningful lives (Sen, 1999).

Murphy and Nagel further argue that taxation is a legitimate expression of the social contract, opposing libertarian claims that it violates property rights (Murphy & Nagel, 2002). While Nozick emphasizes individual liberty and opposes redistributive taxation, modern fiscal policy tends to integrate both Rawlsian justice and Nozickian efficiency by promoting moderate progressive taxation alongside incentives for growth and investment. Thus, tax justice demands a balanced approach combining fairness, transparency, and proportionality, particularly for vulnerable economic groups such as MSMEs (Pramana et al., 2025).

### **The Effectiveness of Law**

The effectiveness of law is a key dimension in assessing how well legal norms achieve their intended objectives and are followed by legal subjects. In the context of taxation, legal effectiveness reflects the ability of the legal system to promote compliance, ensure fairness, and encourage voluntary fiscal contribution (Soekanto, 2008). According to Hans Kelsen, a legal norm is considered effective if it is accepted and followed by society, regardless of its moral or ideological content (Asshiddiqie & Safa'at, 2006). This concept underlies Indonesia's self-assessment tax system, as regulated in Law No. 28 of 2007, which relies on taxpayers' honesty and responsibility in calculating, paying, and reporting their taxes. In practice, however, this system faces challenges such as a narrow tax base, low tax literacy, and aggressive tax avoidance, particularly among large enterprises (Maghfiroh dan Diana, 2016).

Lawrence M. Friedman (1987) argues that legal effectiveness depends on three components: legal substance (the content of the rules), legal structure (the institutions enforcing them), and legal culture (the public's attitudes and behaviour toward the law). In the tax system, fair legal substance such as progressive rates and proportional incentives must be supported by a credible institutional structure like the Directorate General of Taxes (DJP) and a strong culture of tax compliance. These elements must function in synergy to ensure that the tax system is not only operationally effective but also substantively just (Friedman, 1987).

Furthermore, the effectiveness of tax law is influenced by its adaptability to social and economic dynamics. Law must not merely serve as a means of regulation but also as an instrument of social engineering. In this regard, policy socialization, public participation in regulatory design, and administrative simplification are crucial strategies for increasing compliance especially among MSME actors. Therefore, the effectiveness of tax law rests on its ability to balance legal certainty with substantive justice, creating public trust and reinforcing the state's legitimacy in collecting taxes.

## **Methods**

This study adopts an empirical legal research method to investigate how Micro, Small, and Medium Enterprise (MSME) owners perceive the implementation of Government Regulation No. 7 of 2021 and Government Regulation No. 55 of 2022, focusing on legal certainty and fairness in tax practices. Rather than analyzing the law solely from a normative perspective, this approach emphasizes how legal norms are interpreted and applied in actual social contexts (Marzuki, 2007).

A qualitative method was chosen to explore the lived experiences and perceptions of MSME owners, as legal subjects, in relation to tax regulations. Data were collected through semi-structured interviews with eight MSME owners from various sectors across urban and rural areas in East Java Province. This province was selected due to its high number and diversity of MSMEs, allowing for a nuanced understanding of how tax law is perceived on the ground.

The interview data were analyzed using thematic analysis, a qualitative method for identifying and interpreting recurring patterns or themes (Braun & Clarke, 2006; Castleberry & Nolen, 2018; Liu et al., 2020; Neuendorf, 2018; Tuckett, 2005; Turunen et al., 2013). This method supports the study's goal to assess the gap between legal design and legal experience through the lens of both John Rawls's theory of justice (1971) and Lawrence Friedman's theory of legal effectiveness (1987), combining normative ideals with real-world observations.

## **Data**

The primary data for this study came from semi-structured interviews conducted with eight MSME owners in East Java, a region selected for its substantial and varied MSME population across sectors such as agriculture, services, trade, and manufacturing. The combination of urban and rural perspectives ensured contextual relevance to the study of legal implementation.

Participants were recruited using purposive sampling, considering variation in business type, scale, registration status, and tax compliance. Interviews explored core topics including tax awareness, legal understanding, perceived fairness, and administrative challenges. All interviews were conducted in Bahasa Indonesia, audio-recorded with consent, and transcribed verbatim for analysis.

The transcripts served as the primary qualitative data and were analyzed through thematic analysis (Braun & Clarke, 2006; Neuendorf, 2018). This method enabled the researcher to identify both manifest and latent meanings in the data and provided empirical grounding for evaluating the real-world impacts of PP No. 7/2021 and PP No. 55/2022.

## **Data Analysis**

The analysis of qualitative data in this study followed the steps of thematic analysis (Braun & Clarke, 2006; Castleberry & Nolen, 2018; Neuendorf, 2018). Thematic analysis was chosen for its flexibility and effectiveness in identifying, organizing, and interpreting key themes from textual data, particularly interview transcripts. The stages are described as follows:

1. **Data Familiarization.** The first step was to become intimately familiar with the data. All interviews were transcribed verbatim, and the researcher read and reread the transcripts to develop a deep understanding of the content (Braun & Clarke, 2006; Neuendorf, 2018). During this stage, preliminary notes and reflections were recorded to identify recurring ideas, phrases, or concepts that could signal emerging patterns in participants' responses.
2. **Initial Coding.** Once the data were familiar, the researcher proceeded to code meaningful units of text. Coding involves labelling segments of data that relate to particular research concerns, such as understanding of tax obligations, perceptions of fairness, and experience with legal certainty (Castleberry & Nolen, 2018). The coding was done inductively, meaning that categories emerged from the data rather than from pre-established frameworks. NVivo software was not used; manual coding was performed to maintain interpretive closeness to the raw data.
3. **Theme Development.** Following the initial coding, related codes were grouped into broader categories, forming potential themes (Braun & Clarke, 2006). These themes represented patterns of meaning that directly responded to the research question. The initial set of themes was reviewed and refined to ensure coherence and internal consistency. Codes that were too narrow or unrelated were either discarded or merged into more comprehensive thematic clusters. This process continued until thematic saturation was achieved—i.e., no new themes were identified in the data.
4. **Thematic Interpretation.** In this stage, the researcher interpreted each theme in light of the study's conceptual framework, connecting empirical insights to existing literature (Braun & Clarke, 2006; Neuendorf, 2018). The interpretation explored how MSME owners perceive the legal and procedural elements of tax regulation, and how these perceptions reflect broader issues of legal effectiveness and justice.
5. **Conclusion Drawing.** The final step involved synthesizing the findings into a coherent narrative. The conclusions aimed to answer the central research question and contribute to theoretical and practical discussions on tax law and MSME regulation. Interpretations were supported by direct quotes from participants and analysed through the lenses of Rawls's theory of justice and Friedman's theory of legal effectiveness.

## ***Result and Discussion***

### **Analysis of MSME Owners' Perceptions on the Implementation of Government Regulation No. 7 of 2021 and Government Regulation No. 55 of 2022**

This study analyzed how MSME owners perceive the implementation of Government Regulation No. 7 of 2021 and Government Regulation No. 55 of 2022, with specific attention to legal certainty and tax fairness. The findings, based on thematic analysis of eight interview transcripts, reveal four interrelated yet distinct issues: limited awareness of the regulations, misunderstandings of tax obligations, perceived inequity of the final tax scheme, and structural barriers to compliance. These themes indicate a persistent disconnect between legal design and practical implementation, especially among MSMEs in peripheral or resource-constrained areas.

## Limited Awareness of Regulatory Provisions

A key finding of this study is the limited awareness among MSME owners regarding Government Regulation No. 7 of 2021 and Government Regulation No. 55 of 2022. Several interviewees admitted they had never encountered these regulations, highlighting a serious deficiency in legal dissemination. One participant (MSME ABC) noted:

“I have never heard of PP No. 7 or PP No. 55. I usually just follow what the cooperative officer or more experienced friends say.”

Such testimonies highlight a critical lack of legal dissemination, where the state's regulatory instruments fail to reach the intended actors, resulting in a reliance on informal knowledge networks. This condition is indicative of a systemic communication gap rather than mere individual negligence. Soekanto (1983) asserts that legal norms must be internalized socially to achieve effective implementation. In this context, the absence of targeted outreach and structured legal education obstructs the internalization process, rendering the regulations legally valid but socially invisible. The issue is particularly severe in non-urban areas where the presence of state institutions is limited. Panjaitan et al. (2024) note that MSME actors in rural regions are especially susceptible to regulatory exclusion due to weak institutional access and low media penetration. This leads to a form of information poverty that obstructs compliance and widens the legal gap.

Moreover, the failure to equitably disseminate such critical legal information contravenes Article 28D (1) of the 1945 Constitution, which guarantees legal certainty and equal recognition before the law. This constitutional principle remains aspirational if key economic stakeholders such as MSMEs operate in a regulatory vacuum. From a justice-based perspective, Rawls (1971) theory of distributive justice is relevant here. Regulations that fail to inform the least advantaged actors fall short of redistributive fairness. Consequently, the lack of awareness among MSMEs must be viewed not merely as a knowledge deficit, but as a structural failure that undermines both regulatory effectiveness and justice outcomes.

## Misunderstanding of Tax Obligations

Alongside limited awareness, many MSME owners showed a fundamental misunderstanding of their specific tax obligations. Interview data revealed confusion about eligibility thresholds, taxable income, and registration as Taxable Entrepreneurs (PKP). One participant (MSME GHI) confessed,

“I thought every business had to pay tax, no matter the income.”

This reflects a misalignment between legal expectations and taxpayer comprehension, which impedes informed decision-making. Friedman (1987) contends that law must be accepted and understood by the public to function effectively. When legal provisions such as the 0.5% final tax scheme are poorly understood, they become sources of anxiety rather than facilitation. Misinterpretation can result in either over-compliance, such as unnecessary payments, or disengagement rooted in fear of non-compliance.

Musimenta et al. (2017) affirm that the perception of fairness and clarity in taxation significantly shapes compliance behavior among SMEs. The lack of distinction between exempt and non-exempt statuses creates uncertainty, especially among new or informal business actors unfamiliar with legal categories.

Moreover, Sianipar and Apriliasari (2022) emphasize that technical legal content must be tailored to match the audience's linguistic and cognitive abilities. In the absence of such tailored strategies, MSME actors often depend on informal or second-hand knowledge, increasing the likelihood of distorted interpretations and procedural errors.

This misunderstanding, viewed through Rawls (1971) framework, reveals an ethical shortfall. A simplified tax scheme cannot be considered just if it is inaccessible in practice. The inability of the least advantaged to benefit from simplification due to misunderstanding renders the redistribution claim ineffective. Thus, correcting misperceptions must become a priority in tax reform and institutional communication.

### **Perceived Inequity of the Final Tax Scheme**

While designed to ease compliance, the flat 0.5% final tax rate was perceived by many MSME actors as inequitable. The uniformity of the scheme fails to account for differences in scale and profitability. One participant from the agriculture sector (MSME DEF) lamented,

*“Even when I earn very little, I’m still taxed. It doesn’t feel fair.”*

This statement underscores the unintended regressive impact of a supposedly neutral rate. For microenterprises with inconsistent cash flow, the flat tax translates into a proportionally heavier burden. The design’s simplicity does not consider business heterogeneity, leading to perceptions of imbalance. Musimenta et al. (2017) found that perceived fairness in taxation is a central determinant of voluntary compliance, especially among smaller enterprises.

The regulation’s formal equality applying one rate to all masks the substantive inequalities it produces. Rawls (1971) difference principle allows inequality only when it benefits the least advantaged. In this case, the policy’s uniformity may, in fact, undermine that very principle by placing disproportionate pressure on micro-scale actors. Participants suggested that profit-based adjustments or minimum thresholds could mitigate this imbalance. Such mechanisms would preserve administrative efficiency while enhancing equity. As it stands, the current scheme promotes formal equality but neglects the need for proportional burden-sharing.

In conclusion, the perceived inequity of the final tax scheme does not originate from a rejection of the principle of taxation itself, but rather from the prevailing sentiment that the existing regulatory framework fails to account for the heterogeneous economic conditions of MSME actors. Therefore, any reform initiative grounded in principles of fiscal justice must incorporate structural flexibility and contextual sensitivity within simplified taxation mechanisms to ensure their equitable applicability across diverse business profiles.

### **Structural Barriers to Compliance**

Beyond legal awareness and interpretation, many MSME actors described structural barriers as key obstacles to compliance. These include digital illiteracy, bureaucratic complexity, and limited access to administrative assistance. As one respondent (MSME H.1) described

*“I don’t even understand how to report online. I just wait until someone tells me what to do.”*

This reflects how systemic and infrastructural shortcomings, rather than personal unwillingness, impede engagement with the tax system. The government's reliance on self-assessment and digital reporting presumes a level of institutional and technological readiness not available to all MSMEs. Friedman (1987) warns that legal effectiveness is compromised when enforcement mechanisms exceed the operational capacity of the governed community.

Sianipar and Apriliasari (2022) argue that legal tools must be embedded within enabling environments that offer interpretive support and technical training. In rural and semi-urban areas, such support systems are often absent, exacerbating the exclusion of digitally and administratively vulnerable MSME actors.

This creates a form of indirect discrimination, where compliance becomes a function of digital fluency and administrative literacy. Consequently, legal certainty central to the rule of law is weakened, as individuals fail to comply not out of evasion but due to incapacity. Applying Rawls's (1971) theory, these structural gaps undermine the equitable implementation of taxation. A fair regulatory system should not merely apply uniformly, but should also provide the necessary means for all actors to participate meaningfully. Without targeted interventions such as simplified offline mechanisms and localized support compliance will remain inaccessible for a significant segment of the MSME sector.

## **Conclusion**

This study aimed to explore the perceptions of MSME owners regarding the implementation of Government Regulation No. 7 of 2021 and Government Regulation No. 55 of 2022, with a focus on legal certainty and tax fairness. Through qualitative analysis of interview data from MSMEs in East Java, several recurring themes were identified, including limited awareness of the regulations, misunderstandings regarding tax obligations, and perceived inequities in tax treatment.

The results suggest that the flat 0.5% final tax scheme is seen as burdensome by many MSMEs, particularly those with small or fluctuating profit margins. The administrative complexity of self-assessment and insufficient digital literacy further hinder compliance. These issues are compounded by a lack of accessible and accurate information, especially in rural areas, weakening the legal certainty guaranteed by the Constitution.

Moreover, the study found that MSME actors seek not only simplified procedures but also stronger support systems, including practical education, personalized assistance, and better communication from tax authorities. These findings underscore the importance of adopting a justice-oriented and capability-based approach to tax policy.

While the study focused specifically on eight MSME cases in East Java, the insights gained provide valuable input for future regulatory reforms. By highlighting the disconnect between legal design and implementation, this research calls for more inclusive, responsive, and equitable policies that empower MSMEs and foster sustainable tax compliance. Future studies could expand this scope by including a broader geographic sample or examining the impact of improved outreach and education initiatives on compliance behaviour.

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