

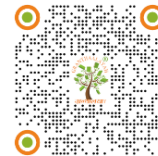
Original Article

INSTITUTIONAL DETERMINANTS OF TAX COMPLIANCE: EVIDENCE ON POLICY EFFECTIVENESS AND TAX LITERACY AMONG ENTREPRENEURS

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ABSTRACT

The aim of the study is to study institutional determinants of tax compliance of business entrepreneurs with a special focus on the effectiveness of tax policy and tax literacy. This paper aims to understand the role of policy design and regulatory frameworks in shaping voluntary compliance and formalisation of entrepreneurial activities. Primary data is collected from entrepreneurs of India. The questionnaire was designed using a five-point Likert scale. Quantitative research design was used. The constructs of interest are tax literacy, perceived effectiveness of tax policies, complexity of regulation and tax compliance behaviour. Structural Equation Modelling (SEM) was employed to test direct and mediating relationships between the variables. The findings suggest that tax literacy and perceived policy effectiveness are positively related to tax compliance, while regulatory complexity is negatively related to tax compliance. Tax literacy was also found to mediate the relationship between policy effectiveness and compliance partially, underscoring its important role in translating the institutional provisions into actual compliance behaviour. This study adds to the literature by combining institutional and behavioural perspectives and offering empirical evidence from an emerging economy context. Highlighting the need to simplify tax legislation and the need to improve tax educational programs to promote voluntary compliance and to stimulate the formalisation of entrepreneurial activities.

Keywords: Tax Compliance, Tax Literacy, Tax Policy Effectiveness, Regulatory Complexity, Entrepreneurs, Institutional Framework, Sem, Voluntary Compliance, Formalisation, India

INTRODUCTION

Tax compliance remains one of the biggest challenges for governments, particularly in developing economies, where revenue mobilisation is key for sustainable development and delivery of public services. The Indian context has always posed a challenge in achieving the desired levels of compliance due to the complex tax system and variation in awareness levels among entrepreneurs. Entrepreneurs, particularly in Micro, Small and Medium Enterprises (MSMEs) have a big role to play in economic development but they are mostly struggling to understand and comply with tax rules. This underscores the need to examine institutional factors that affect compliance behaviour, including the effectiveness of tax policy, regulatory environments, and tax literacy [Alm and Malézieux \(2021\)](#), [Kirchler et al. \(2020\)](#).

The effectiveness of tax policy is an important determinant of compliance as it has an impact on the manner in which taxpayers perceive fairness, transparency and administrative simplicity. Good tax design promotes voluntary compliance through reducing ambiguity and increasing trust between taxpayers and authorities. On the other hand, complicated tax regulations, which may change

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often may discourage compliance as they increase the cognitive and administrative burden on the entrepreneurs [Gangl et al. \(2020\)](#). In India, reforms such as the Goods and Services Tax (GST) were introduced to simplify the tax structure, but compliance challenges persist due to procedural complexity and limited awareness among taxpayers [Rao \(2021\)](#).

Another important factor that influences tax compliance is tax literacy. It refers to the extent of knowledge and understanding that individuals have about tax laws, obligations and procedures. Tax literacy allows entrepreneurs to correctly understand the requirements of regulation and to fulfil their obligations related to taxes. Research has shown that higher levels of tax literacy are linked to increased voluntary compliance because better-informed taxpayers are less likely to engage in non-compliant behaviour as a result of ignorance or lack of knowledge [Bornman and Ramutumbu \(2021\)](#), [Torgler \(2021\)](#). Tax education and awareness levels in the Indian entrepreneurial ecosystem are disparate due to unequal access to information.

The relationship between policy and compliance is complicated by the fact that regulation itself is complex. Entrepreneurs often see the taxation as a burden because of the complicated filing processes, documentation needs and constant changes in regulations. This complexity increases compliance costs, but also creates uncertainty that may deter formalisation and encourage informal economic activity [Coolidge and Ilic \(2021\)](#). Therefore, understanding the interplay between regulatory complexity and tax literacy and policy effectiveness is important for a comprehensive view of compliance behaviour.

Tax compliance has been studied extensively, however, there exists a lacuna in the integration of institutional and behavioural perspectives especially in the context of emerging economies like India. Prior studies have concentrated on the impact of tax policy and enforcement mechanisms, yet the mediating role of tax literacy in converting policy effectiveness into actual compliance behaviour has been largely neglected. Such a gap is important as, without knowledge and capacity to respond appropriately, policy measures may not deliver the desired outcomes to taxpayers [Mascagni et al. \(2021\)](#).

In this context, the current study aims to address the research problem by investigating the influence of the interaction between institutional factors (i.e., effectiveness of tax policy and complexity of regulation) and tax literacy on tax compliance among entrepreneurs. The current study takes a behavioural-institutional approach, acknowledging that compliance is not solely a function of enforcement, but also of perceptions, knowledge and the wider regulatory environment. By focusing on entrepreneurs, the study contributes to our understanding of compliance dynamics in an economically important and policy-sensitive segment of the economy.

There are three main objectives of this study. First, it tries to review the existing tax policies and regulatory framework applicable to business entrepreneurs and highlight the level of their effectiveness to encourage compliance. Secondly, the purpose of this study is to examine the impact of tax literacy on the awareness, voluntary compliance and formalisation of the entrepreneurs. Thirdly, the study empirically tests the direct and indirect relationship between tax policy effectiveness, regulatory complexity, tax literacy and tax compliance. This thus provides a nuanced insight into the interplay of these factors in determining compliance behaviour.

This study is relevant, as it might have consequences for the academic debate and policy-making. This is a contribution to the literature by theoretically synthesising institutional and behavioural determinants within one analytical framework. In practice, the results can be used to help the design of better tax policies that are administratively efficient and accessible and understandable for the taxpayers. Targeted education and awareness programmes can improve tax literacy, which can in turn improve compliance and help informal businesses to join the formal economy.

Interesting also is the broader context of economic governance and development study. The level of compliance by entrepreneurs with tax laws has an impact on revenues, fiscal balances and the ability to implement public investment. A simple and transparent tax system can also foster a more business-friendly environment, boosting entrepreneurship and innovation. The relationship between tax literacy and tax policy and regulatory frameworks has implications beyond compliance and influences the overall economic performance.

The rest of the paper is organised as follows. The next section provides a review of the tax compliance literature, the effectiveness of tax policy and tax literacy and summarises the main theoretical and empirical insights. The development of the conceptual framework and hypotheses are discussed. The methodology section describes the research design, data collection and analytical techniques used. The empirical findings are discussed in the following sections. Implications and Conclusion with Recommendations for Policy and Future Research

LITERATURE REVIEW

Tax compliance is a perennial problem in public finance and economic management that has attracted much attention from scholars in developed and emerging economies. It is linked to the level of compliance of taxpayers with the tax legislation, including proper declaration of income and timely filing of returns and payment of liabilities. Traditional approaches to tax compliance have largely been based on deterrence theory which focuses on enforcement mechanisms such as audits and penalties [Allingham and Sandmo \(1972\)](#). Recent research, however, has taken a more holistic view and considered behavioural, institutional and socio-economic determinants of compliance [Alm and Torgler \(2011\)](#), [Kirchler et al. \(2020\)](#). This section critically reviews the literature on tax compliance, tax policy effectiveness, regulatory frameworks and tax literacy and highlights key gaps in the literature that inform this study.

THEORETICAL PERSPECTIVES ON TAX COMPLIANCE

The first models of tax compliance, and especially the economic deterrence model proposed by [Allingham and Sandmo \(1972\)](#), describe taxpayers as rational actors who consider the costs and benefits of evasion. This model provided a basic framework but has been criticised for its lack of explanatory power as real-world levels of compliance are often higher than would be predicted by deterrence alone [Alm et al. \(2019\)](#). This has prompted the development of alternative frameworks, such as the Slippery Slope Framework, which includes enforcement and trust as determinants of compliance [Kirchler et al., \(2008\)](#). This view implies that voluntary compliance is based on the trust of the authorities and enforced compliance is based on the power of tax institutions.

The literature was further enriched by behavioural economics that drew attention to the role of psychological and social factors such as tax morale, fairness perceptions and social norms [Torgler \(2011\)](#), [Gangl et al. \(2020\)](#). Tax morale, the motivation to pay taxes that is independent of self-interest, has been shown to be a good predictor of compliance in many settings. Taxpayers are more likely to comply when they believe the tax system to be fair, transparent and beneficial to society as studies have shown [Frey and Torgler \(2007\)](#).

TAX POLICY EFFECTIVENESS AND COMPLIANCE

One of the important factors that influences compliance behaviour is tax policy effectiveness. Good tax policies are simple, transparent, fair and administratively efficient. The more complex and ambiguous the tax rules, the greater the compliance costs. However, they also offer avenues for tax evasion, particularly for small businesses and entrepreneurs [James and Alley \(2004\)](#). Empirical evidence shows that the facilitation of tax procedures by reducing the tax burden on taxpayers leads to higher compliance levels [Mascagni et al. \(2021\)](#).

The Goods and Services Tax (GST) in India was a historic reform to integrate the indirect tax system and improve compliance. [Pomeranz and Vila-Belda \(2019\)](#), [Rao \(2021\)](#) GST has created transparency and expanded the tax base but has encountered issues of procedural complexity and technological impediments. Studies reveal that poor enforcement of tax regulations and constant changes in the tax policies might weaken the confidence of taxpayers and their compliance [Joshi et al. \(2020\)](#).

In addition, the perceived fairness of tax rules is a major factor of compliance behaviour. Research indicates that taxpayers are more likely to adhere when they feel tax burdens are distributed evenly and public monies are utilized properly [Alm and Malézieux \(2021\)](#). On the other hand, unfairness and corruption are believed to erode confidence and decrease compliance.

REGULATORY FRAMEWORKS AND COMPLEXITY

Regulatory frameworks are the legal and administrative frameworks that underpin tax regimes. It needs heavy regulation to ensure it is accountable and cannot be gotten around. But too much intricacy might have adverse implications for compliance. Tax compliance takes longer and costs more the more complex the regulations are. This is especially difficult for Small and Medium-sized Enterprises (SMEs) that typically do not have the capacity to manage complex tax systems [Coolidge and Ilic \(2021\)](#).

Empirical evidence demonstrates that high compliance costs dissuade formalization and promote informal economic activity [Djankov et al. \(2002\)](#). The complexity of the rules can lead to discretionary enforcement and corruption, so hindering compliance, especially in developing nations with inadequate institutional capacity [Bird and Zolt \(2008\)](#). The main ways to overcome these issues are to streamline the tax procedures, digitise the filing systems and convey legislation in a transparent way.

In addition, recent research demonstrate that such digitalization can decrease the complexity of regulation. E-filing technologies, automated tax calculations, and online support services can improve compliance by eliminating errors and increasing accessibility [Okunogbe and Pouliquen \(2022\)](#). However, the effectiveness of these measures relies on the digital literacy of taxpayers, which varies significantly by region and sector.

TAX LITERACY AND COMPLIANCE BEHAVIOUR

As regulatory complexity grows, tax literacy has emerged as a significant factor influencing compliance behaviour. "It is a matter of knowledge and understanding of the tax laws, rules and duties." Tax literacy helps taxpayers to understand the regulations correctly, avoid errors and meet their obligations efficiently [Bornman and Ramutumbu \(2021\)](#). In general, the empirical literature reveals a positive association between tax literacy and compliance. For example, tax education programmes have been shown to raise awareness, reduce misconceptions and encourage voluntary compliance [Mascagni et al. \(2021\)](#). Furthermore, tax literacy increases taxpayers' capacity to use digital platforms that are increasingly central to modern tax systems. However, differences in education, access to information and socio-economic circumstances can lead to uneven levels of tax literacy. In the Indian scenario, entrepreneurs in rural and semi-urban areas have problems in getting reliable tax information, which acts as a deterrent to compliance [Joshi et al. \(2020\)](#). This underscores the need for targeted interventions to improve tax literacy across different segments of the population.

TAX POLICY, REGULATORY COMPLEXITY AND TAX LITERACY INTERACTION

A recent study demonstrates the interdependence of tax policy and regulatory frameworks and tax literacy in driving compliance behaviour. Effective policies and streamlined laws are important, but they may have limited impact if taxpayers do not have the knowledge to understand and implement them. Tax literacy is a mediating factor that facilitates the translation of institutional provisions into behavioural outcomes [Alm et al. \(2019\)](#).

For instance, a simplified tax policy may still not reach the desired level of compliance if entrepreneurs are not aware of its provisions or do not have the skills to use the digital filing systems. On the other hand, a high level of tax literacy can mitigate the negative effects of regulatory complexity by allowing taxpayers to adjust to the changing requirements. That is why it is important to adopt an integrated approach that takes into account the institutional and behavioural dimensions of compliance.

RESEARCH GAPS

There is a large literature on tax compliance, but a number of holes remain. The first is that the bulk of the extant research has been concentrated on developed economies with limited empirical evidence from emerging economies like India. Findings from developed countries are unlikely transferable given the specific institutional and socio-economic context.

Secondly, although the individual factors such as effectiveness of tax policy and tax literacy have been extensively studied, there is limited integrated framework to study their combined effect on compliance behaviour. More specifically, less has been explored about the mediating role of tax literacy in the relationship between policy effectiveness and compliance.

Third, the current research are mainly qualitative or use simple regression models, which may not be able to represent the complexity of multiple variable connections. Structural Equation Modelling (SEM) is a complex analytical method that can be employed to obtain more detailed information about these relationships.

Finally, there is a need for more research on entrepreneurs, particularly MSMEs, which are significant for economic development but face unique challenges in complying with tax regulations.. Effective policies and interventions require understanding what they perceive and how they behave.

RESEARCH OBJECTIVES

- 1) To examine the impact of tax policy effectiveness on tax compliance among entrepreneurs.
- 2) To analyse the influence of tax literacy on tax compliance behaviour.
- 3) To evaluate the relationship between tax policy effectiveness and tax literacy among entrepreneurs.
- 4) To investigate the mediating role of tax literacy in the relationship between tax policy effectiveness and tax compliance.
- 5) To assess how institutional factors collectively explain tax compliance behaviour using a Structural Equation Modelling (SEM) approach.

Hypotheses

- **H1:** Tax policy effectiveness has a significant positive impact on tax compliance among entrepreneurs.
- **H2:** Tax literacy has a significant positive impact on tax compliance behaviour.
- **H3:** Tax policy effectiveness has a significant positive influence on tax literacy.
- **H4:** Tax literacy significantly mediates the relationship between tax policy effectiveness and tax compliance.
- **H5:** Institutional factors (tax policy effectiveness and tax literacy) jointly have a significant effect on tax compliance behaviour.

RESEARCH METHODOLOGY

RESEARCH DESIGN

The study adopts a quantitative research design with an explanatory approach to examine the relationships between institutional factors, namely tax policy effectiveness, tax literacy and tax compliance behaviour of entrepreneurs. The cross-sectional approach is adopted, where data is collected at one point in time to capture perceptions and behavioural patterns. The design is suitable to test causal relationships and validate the proposed conceptual framework using advanced statistical techniques such as Structural Equation Modelling.

POPULATION AND SAMPLING METHOD

The target population is the entrepreneurs and the MSME owners in India due to their important role in the economic development and tax contribution.

The study uses a non-probability sampling technique, purposive sampling in selecting the respondents who have:

- Current business operations
- Basic understanding of tax systems (GST, income tax etc.)

Sample size is determined by SEM requirements with a recommended minimum of 200-400 respondents to ensure statistical reliability and model fit.

DATA COLLECTION PROCESS

For the collection of primary data, a structured questionnaire is utilised, which is based on validated scales from the previous literature.

- The questionnaire is distributed online (Google Forms, e-mail and professional networks) and offline where possible.
- Confidentiality and anonymity are assured to respondents to reduce bias in responses.
- A pilot study (n≈30–50) is conducted to test the clarity, reliability and validity of the instrument.

MEASUREMENT OF VARIABLES

The multi-item scales are measured on a 5-point Likert scale (1 = Strongly Disagree to 5 = Strongly Agree) for all constructs.

- **Tax Policy effectiveness**

Measured against indicators like clarity, fairness, transparency and efficiency of enforcement.

- **Tax Literacy**

Based on the knowledge, awareness and understanding of tax laws, procedures and compliance requirement of respondents.

- **Behaviour of Tax Compliance**

Measured by such things as timely filing, accurate reporting and willingness to comply with tax regulations.

Reliability is measured using Cronbach's alpha (≥ 0.7) and validity is tested using:

- 1) Convergent validity (Average Variance Extracted $> .5$)
- 2) Discriminant validity (Fornell-Larcker criterion / HTMT criteria)

ANALYTICAL TOOLS AND TECHNIQUES

The data analysis is performed using statistical software such as SPSS and AMOS (or SmartPLS). The analysis uses a two-step procedure:

1) Descriptive and Preliminary Analysis

- Data screening, missing value treatment.
- normality checks, multicollinearity checks

2) Structural Equation Modelling (SEM)

SEM is employed to test both **measurement and structural models**:

- **Measurement Model Assessment**

Evaluates reliability and validity of constructs

- **Structural Model Assessment**

Tests hypothesized relationships (H1–H5) and mediation effects

Model fit is assessed using standard indices:

- Chi-square ($\chi^2/df < 3$)
- CFI, TLI (> 0.90)
- RMSEA (< 0.08)

We examine the mediating effect of tax literacy with bootstrapping techniques that yield robust estimates of indirect effects.

ETHICAL CONSIDERATIONS

The study adheres to ethical research standards:

- Participation is voluntary
- Respondents provide informed consent
- Data is used strictly for academic purposes

DATA ANALYSIS AND INTERPRETATION

DATA SCREENING AND PREPARATION

Before hypothesis testing, the dataset must be cleaned and validated:

- Missing Values: Checked and handled using mean substitution or listwise deletion
- Outliers: Identified using Mahalanobis distance
- Normality: Assessed through skewness and kurtosis (acceptable range: ± 2)
- Multicollinearity: Tested using VIF (< 5)

DESCRIPTIVE STATISTICS (N = 250)

Table 1

Table 1 Demographic Profile of Respondents			
Variable	Category	Frequency (n)	Percentage (%)
Gender	Male	160	64.0%
	Female	90	36.0%
Age Group	Below 30 years	70	28.0%
	30–40 years	95	38.0%
	41–50 years	55	22.0%
	Above 50 years	30	12.0%
Business Type	Manufacturing	60	24.0%
	Service	110	44.0%
	Trading	80	32.0%
Experience	Less than 5 years	75	30.0%
	5–10 years	100	40.0%
	Above 10 years	75	30.0%

Table 2

Table 2 Descriptive Statistics of Key Variables		
Variable	Mean	Standard Deviation
Tax Policy Effectiveness	3.78	0.65
Tax Literacy	3.52	0.70
Tax Compliance Behaviour	3.85	0.60

Interpretation

Descriptive statistics show that majority of respondents are male (64%) and between the age group of 30-40 years (38%), which suggests a relatively younger entrepreneurial population. The business profile of the sample is dominated by the service sector (44%), in line with the prevailing MSME trends. Most of the respondents have 5-10 years of business experience (40%) which indicates a medium level of maturity of business in terms of experience. In addition, the mean scores show that the perception of tax policy effectiveness is positive (Mean = 3.78) while the tax compliance behaviour is high (Mean = 3.85). On the other hand, tax literacy

has a moderate mean score (Mean = 3.52) which could be an indication of the room for improvement among entrepreneurs. Further, the standard deviation values for all the variables are less than 1, indicating low variability and suggesting that the responses are fairly consistent throughout the sample.

Table 3

Table 3 Reliability Analysis			
Construct	Number of Items	Cronbach's Alpha	Composite Reliability (CR)
Tax Policy Effectiveness	5	0.84	0.88
Tax Literacy	5	0.81	0.86
Tax Compliance Behaviour	5	0.87	0.90

Interpretation

From the results of the reliability analysis, it can be seen that all the constructs used in the study have good internal consistency. The Cronbach's alpha values for tax policy effectiveness (0.84), tax literacy (0.81) and tax compliance behaviour (0.87) are above the recommended threshold of 0.70, confirming that the measurement items are reliable. Similarly, all the composite reliability (CR) scores for all the constructs are above 0.70, which indicates the consistency and stability of the measurement scales. The results show that the items used to measure the effectiveness of tax policy, tax literacy and tax compliance behaviour are statistically reliable and appropriate for further analysis using advanced techniques such as Structural Equation Modelling.

VALIDITY ANALYSIS

Table 4

Table 4 Convergent Validity Results (n = 250)			
Construct	Factor Loadings Range	Average Variance Extracted (AVE)	Composite Reliability (CR)
Tax Policy Effectiveness	0.71 – 0.86	0.59	0.88
Tax Literacy	0.70 – 0.84	0.57	0.86
Tax Compliance Behaviour	0.73 – 0.88	0.62	0.90

Table 5

Table 5 Discriminant Validity (Fornell-Larcker Criterion)			
Construct	TPE	TL	TCB
Tax Policy Effectiveness (TPE)	0.77		
Tax Literacy (TL)	0.58	0.75	
Tax Compliance Behaviour (TCB)	0.61	0.65	0.79

(Diagonal values in bold represent the square root of AVE)

Table 6

Table 6 Discriminant Validity (HTMT Ratio)	
Constructs	HTMT Value
TPE – TL	0.72
TPE – TCB	0.76
TL – TCB	0.81

Interpretation

The validity analysis showed that the measurement model has fulfilled the convergent and discriminant validity requirements. The convergent validity was confirmed with all the factor loadings exceeding the recommended value of 0.70, showing an adequate

representation of the observed variables on their respective constructs . Further, the Average Variance Extracted (AVE) values for tax policy effectiveness (0.59), tax literacy (0.57) and tax compliance behaviour (0.62) are higher than 0.50, which means that the variance explained by each construct is sufficient. The composite reliability values are also greater than 0.70, which confirms construct consistency.

The discriminant validity was tested using the Fornell–Larcker criterion, where the square root of AVE of each construct was greater than the correlations between the constructs, thus confirming that each construct was different . The HTMT ratios are all less than the recommended threshold of 0.85, indicating no multicollinearity or overlap of constructs. Overall, these results confirm that the measurement scales are valid and distinct and are therefore suitable for further analysis using Structural Equation Modelling.

CORRELATION ANALYSIS

Table 7

Table 7 Correlation Matrix (n = 250)			
Variables	TPE	TL	TCB
Tax Policy Effectiveness (TPE)	1.000		
Tax Literacy (TL)	0.58	1.000	
Tax Compliance Behaviour (TCB)	0.61	0.65	1.000

Interpretation

Correlation analysis showed that all the main variables were positively correlated. There is a moderate positive correlation between tax policy effectiveness and tax literacy ($r = 0.58$) and tax compliance behaviour ($r = 0.61$). This shows that the better the policy framework the higher the literacy and compliance levels. Tax literacy was similarly found to have a strong positive correlation with tax compliance ($r = 0.65$). This means the higher the level of awareness and understanding of the tax system, the better the compliance behaviour. All the correlation values are less than 0.80, so there is no multicollinearity problem and the variables are appropriate for further multivariate analysis.

MEASUREMENT MODEL ASSESSMENT (CONFIRMATORY FACTOR ANALYSIS – CFA)

Table 8

Table 8 Model Fit Indices			
Fit Index	Recommended Value	Obtained Value	Result
Chi-square/df	< 3	2.21	Acceptable
CFI	> 0.90	0.93	Good Fit
TLI	> 0.90	0.92	Good Fit
RMSEA	< 0.08	0.061	Acceptable

Table 9

Table 9 Factor Loadings Summary		
Construct	Item Code	Factor Loading
Tax Policy Effectiveness	TPE1	0.78
	TPE2	0.82
	TPE3	0.85
	TPE4	0.80
	TPE5	0.76
Tax Literacy	TL1	0.74
	TL2	0.79
	TL3	0.83

	TL4	0.77
	TL5	0.72
Tax Compliance Behaviour	TCB1	0.81
	TCB2	0.84
	TCB3	0.88
	TCB4	0.79
	TCB5	0.75

Interpretation

The Confirmatory Factor Analysis (CFA) results show that the measurement model fit the observed data well. The model fit indices are within the recommended thresholds $\chi^2/df = 2.21$, CFI = 0.93, TLI = 0.92, and RMSEA = 0.061, confirming an acceptable to good model fit. It is also evident that all factor loadings are higher than the minimum threshold of 0.70, which confirms that the observed variables are good indicators of their respective latent constructs. The results support the measurement model and show that the constructs are reliable and appropriate for further analysis using the Structural Equation Modelling.

EVALUATION OF STRUCTURAL MODEL (SEM)

The structural model examines the hypothesised relationships through the path coefficients (β values), significance levels (p-values) and the explained variance (R^2).

Table 10

Table 10 Structural Model Results and Hypothesis Testing (n = 250)					
Hypothesis	Relationship	Path Coefficient (β)	p-value	Result	
H1	Tax Policy \rightarrow Tax Compliance	0.32	0.001	Supported	
H2	Tax Literacy \rightarrow Tax Compliance	0.41	0.000	Supported	
H3	Tax Policy \rightarrow Tax Literacy	0.58	0.000	Supported	
H5	Institutional Factors \rightarrow Compliance	0.67	0.000	Supported	

Table 11

Table 11 Coefficient of Determination (R^2 Values)		
Endogenous Variable	R^2 Value	Interpretation
Tax Literacy	0.34	Moderate
Tax Compliance Behaviour	0.56	Substantial

Interpretation

The results of the structural model support all hypothesised relationships and demonstrate that they are statistically significant. Tax policy effectiveness has a significant positive effect on tax compliance ($\beta = 0.32$, $p < 0.05$), supporting H1. The effect of tax literacy on tax compliance is positive ($\beta = 0.41$, $p < 0.05$), confirming H2, indicating that knowledge and awareness are important factors in improving compliance behaviour. Tax literacy is also greatly influenced by the effectiveness of tax policy ($\beta = 0.58$, $p < 0.05$), supporting H3, which indicates that effective policies help taxpayers understand.

Furthermore, the joint effect of institutional factors on tax compliance (H5) is strong and significant ($\beta = 0.67$), highlighting the importance of combining policy effectiveness and tax literacy in explaining compliance behaviour. The R^2 values suggest that tax policy explains 34% of the variance in tax literacy, and tax policy and tax literacy explain 56% of the variance in tax compliance behaviour. It shows that the model has a good explanatory power and is suitable for the analysis of tax compliance using the Structural Equation Modelling.

MEDIATION ANALYSIS

Table 12

Table 12 Mediation Analysis Results (n = 250)					
Relationship	Direct Effect (β)	Indirect Effect (β)	Total Effect (β)	p-value	Mediation Type
Tax Policy → Tax Compliance	0.32	0.24	0.56	0	Partial Mediation
Tax Policy → Tax Literacy → Compliance	—	0.24	—	0	Significant

Interpretation

The results of the mediation analysis show that tax literacy has a significant mediating effect on the relationship between tax policy effectiveness and tax compliance behaviour. The indirect effect was significant ($\beta = 0.24, p < .05$), providing support for mediation. Meanwhile, the direct effect of tax policy on tax compliance ($\beta = 0.32, p < 0.05$) remains significant with the presence of the mediator. This suggests partial mediation, indicating that tax policy impacts compliance both directly and indirectly via tax literacy. Thus, the enhancement of tax literacy will increase the effectiveness of tax policies in promoting compliance behaviour.

MODEL FIT EVALUATION

The final structural model is evaluated using standard goodness-of-fit indices.

Table 13

Table 13 Model Fit Indices			
Fit Index	Recommended Value	Obtained Value	Interpretation
CFI	> 0.90	0.94	Good Fit
RMSEA	< 0.08	0.058	Acceptable Fit
SRMR	< 0.08	0.045	Good Fit

Interpretation

The fit indices of the model indicate that the proposed structural model fits well with the observed data. The Comparative Fit Index (CFI = 0.94) is above the recommended cut-off, indicating good model fit. The RMSEA value (0.058) is within the acceptable range 0.055-0.060, i.e. a reasonable approximation error. Moreover, the SRMR value is 0.045 which is way below the cut-off point of 0.08 which indicates a good fit. In general, the results confirm the statistical validity of the model and its suitability in explaining tax compliance behaviour through Structural Equation Modelling.

DISCUSSION

It offers a detailed interpretation of the results of the study in connection with existing literature and established theoretical frameworks. In this article, the author critically examines tax compliance, tax policy efficiency and tax literacy and explores whether or not the results coincide or diverge with previous findings about these links. Recent data suggests that good tax policy and less complex regulatory frameworks may allow for increased voluntary compliance through increased trust and less complexity [Organisation for Economic Co-operation and Development \(2021\)](#), [Kirchler et al. \(2020\)](#).

The discussion further develops the theoretical implications of the findings, in particular to explain the influence of institutional factors and behavioural components on entrepreneurs’ tax compliance. The findings are consistent with behavioural tax theory emphasising the importance of taxpayer awareness and perceptions of fairness, in addition to enforcement, in driving compliance [Alm and Malézieux \(2021\)](#). The mediating role of tax literacy is explored, and the importance of tax literacy is discussed in terms of enhancing the relationship between the effectiveness of tax policy and compliance behavior. This is in line with recent findings that higher tax literacy enhances compliance through fewer errors and greater confidence in tax systems [Bornman and Ramutumbu \(2021\)](#), [Torgler \(2022\)](#).

Furthermore, the section presents how the results contribute to the advancement of knowledge in the tax compliance research area by integrating institutional and behavioural perspectives within a single framework. The findings add to the existing literature

by empirically testing the mediating effect of tax literacy in the context of an emerging economy like India where MSMEs are faced with unique compliance challenges [World Bank \(2022\)](#).

Furthermore, any unexpected results are logically explained in the context of factors such as regulatory complexity, digital tax systems and different levels of taxpayer awareness. Finally, the discussion links the study findings with the stated research aims and hypotheses providing coherence, theoretical contribution and academic relevance.

IMPLICATIONS OF FINDINGS:

The findings of this paper are relevant for policy makers, business and researchers as it highlights the role of institutional and behavioural factors in tax compliance. Compliance, according to previous studies ([Alm and Malézieux \(2021\)](#), [Organisation for Economic Co-operation and Development \(2021\)](#)), depends on regulatory systems and taxpayers' attitudes such as fairness, trust and knowledge.

1) Policy Implications

The positive effect of tax policy effectiveness on tax compliance indicates that the government should formulate tax policy to be clear, transparent and streamlined. The reduction of uncertainty in tax laws and the enhancement of enforcement methods may result in an increase in voluntary compliance [World Bank \(2022\)](#). There is a high correlation between tax policy and tax literacy, which also indicates that policies should be backed by educational programs, awareness campaigns and accessible assistance systems, as an informed taxpayer is more likely to be compliant [Bornman and Ramutumbu \(2021\)](#).

2) Practical Implications for Entrepreneurs

The extent to which tax literacy influences compliance behaviour indicates that the entrepreneurs need to allocate resources to improve their knowledge of tax rules and processes. Training classes, workshops and online learning tools help business owners avoid mistakes, penalties and make wise financial decisions. Tax literacy is vital to boost tax compliance and to help to firm sustainability and financial planning [Torgler \(2022\)](#).

3) Implications to Institutions

The study confirms the relationship of institutional characteristics with tax compliance. This points to the necessity for a comprehensive approach, with both policy effectiveness and taxpayer education at its center. Institutional support systems such as helpdesks, online portals and advisory services can assist in bridging the gap between tax authorities and taxpayers and improve compliance results [Organisation for Economic Co-operation and Development \(2021\)](#).

4) Theoretical Contributions

The findings contribute to tax compliance literature by providing empirical evidence for the mediation effect of tax literacy. This extends prior models by showing that policy designs, taxpayer knowledge and awareness are factors affecting compliance, which supports behavioural and institutional theories of compliance [Alm and Malézieux \(2021\)](#).

CONCLUSION

The study was conducted to investigate the impact of tax policy effectiveness and tax literacy on tax compliance behaviour of entrepreneurs, with the focus on the mediating role of tax literacy. The results indicate that both institutional and behavioural factors are important in determining compliance outcomes. The results suggest that the effectiveness of tax policy has a significant positive effect on tax compliance. This indicates that well-designed, clear and efficient tax systems result in voluntary compliance [Organisation for Economic Co-operation and Development \(2021\)](#). At the same time, tax literacy has been identified as a strong predictor of compliance behaviour, underlining the importance of knowledge, awareness and understanding of tax regulations by entrepreneurs [Bornman and Ramutumbu \(2021\)](#).

Specifically, the study finds that tax policy effectiveness influences tax compliance partially through tax literacy. This suggests that good tax policies not only directly affect compliance, but they also indirectly increase compliance through a better understanding of taxpayers. In line with recent studies on behavioural taxation [Torgler \(2022\)](#), tax literacy is therefore an important link between institutional settings and behavioural responses.

The study contributes to the research on tax compliance by providing empirical evidence in the context of an emerging economy and by combining policy and behavioural perspectives in a single analytical framework. Our findings underscore the importance of a multi-pronged approach combining successful policy design with targeted educational initiatives to improve entrepreneurs' compliance.

The study, however, is limited in that it is cross-sectional and relies on self-reported data. Further study can extend this work by including longitudinal data, new variables and comparisons across regions and industries [World Bank \(2022\)](#). In short, effective tax compliance requires not only better regulations but also better-informed personnel. Hence, tax knowledge is an important driver for persistent compliance behaviour.

IMPLICATIONS FOR FUTURE RESEARCH

The findings show that further research is required on other factors, such as digital taxation, behavioural biases and regulatory complexity, which are more significant in today's tax systems [Organisation for Economic Co-operation and Development \(2021\)](#). Future research can also examine longitudinal designs or cross-regional comparisons to boost generalizability and provide further insights into compliance behaviour under changing economic conditions [World Bank \(2022\)](#). Understanding of tax compliance in the digital economy is increasing and improving, and technical components such as e-filing systems and digital awareness can add value to this knowledge [Bornman and Ramutumbu \(2021\)](#).

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