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The psychological pathways of tax fraud under persistent corruption and financial uncertainty in Indonesia

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Abstract

This study explores gaps in the literature on tax fraud (TAFR) by examining how corruption perceptions (COPER) and financial uncertainty (FIUN) influence TAFR. It also investigates whether moral disengagement (MORD) acts as a mediator in these relationships. In doing so, we apply social cognitive theory (SCT) as the framework. Uniquely, this study is based on insights gathered from the owners of Indonesian small-sized enterprises operating in East Java Province. The findings suggest that COPER does not directly cause TAFR but influences it indirectly through MORD. This challenges the idea that being aware of corruption automatically leads to unethical behaviour. On the other hand, FIUN has a direct impact on TAFR that economic hardship can drive people to make immediate, practical decisions to survive, without relying on cognitive justifications. Theoretically, this study highlights how corruption and financial pressures work together to shape unethical choices related to tax compliance. Practically, this study offers valuable insights for policymakers and regulators. In general, this study provides a more comprehensive view of tax fraud by moving beyond simple cause-and-effect models to a deeper understanding of its drivers in emerging economies.

Introduction

Empirically, it is very important to note that the persistence of tax fraud remains a critical challenge for emerging economies, where weak institutional frameworks and pervasive corruption often exacerbate financial uncertainty (Wang, 2022; Ngah et al., 2020). Despite a growing body of research addressing tax compliance behaviours (Kamleitner et al., 2012; Belahouaoui & Attak, 2024; Radulović & Savić, 2024), significant gaps persist in understanding the underlying cognitive and psychological mechanisms that drive tax fraud, particularly within the context of small-sized businesses. Other studies also have frequently concentrated on macroeconomic determinants or institutional governance, exploring themes such as the impact of tax rates and penalties on compliance, the role of regulatory quality and enforcement intensity, and the influence of economic growth or contraction on tax evasion tendencies (Anesa & Bressan, 2024; Satyadini & Rosid, 2024). These studies argue that higher tax rates incentivise evasion, while stricter enforcement mitigates non-compliance, framing the issue as a cost-benefit calculation rooted in rational choice theory. Other scholars delve into institutional governance, emphasising the role of corruption, political stability, and public trust in authorities in shaping tax behaviours (Xie et al., 2019; Wang, 2022). They argue that weak institutions and pervasive corruption erode trust in the tax system, thereby normalising non-compliance and diminishing the perceived legitimacy of tax obligations. Similarly, these works (Nyantakyi et al., 2024; Audretsch et al., 2022) suggest that political instability and inconsistent enforcement reduce the deterrence effect of penalties, further encouraging fraudulent

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activities. However, these streams of research primarily prioritise external and structural determinants. They overlook the psychological and cognitive factors that mediate individuals' ethical reasoning processes. While valuable, such approaches fail to capture the routine interplay of internal psychological mechanism, such as moral disengagement and ethical self-regulation (Bandura, 2001), that often underpin tax fraud. As such, this oversight leaves a critical gap in understanding how individuals navigate and rationalise unethical decisions, particularly in the high-pressure and resource-constrained environment of small-sized businesses.

Moreover, existing literature on COPER often frames it as an exogenous variable influencing organisational and individual decision-making processes (Bahoo et al., 2020; Bani-Mustafa et al., 2024; Epstein & Gang, 2024). However, such perspectives frequently oversimplify the dynamic and multifaceted interrelations between corruption and unethical practices, including tax fraud. Those studies conceptualise corruption as a structural or environmental factor, that treat it as a static backdrop against which compliance behaviours unfold. This reductive framing neglects to account for the bidirectional and context-sensitive nature of corruption perceptions, which can simultaneously incentivise deviance while fostering counteracting forces of moral conflict and ethical behaviour (Takacs Haynes & Rašković, 2021). Although the argument that high corruption perceptions normalise deviant behaviours finds support in studies emphasising the erosion of institutional trust and the legitimisation of unethical norms (Forkmann et al., 2022; Megías et al., 2023), this line of reasoning inadequately explores the heterogeneity of individual responses to corrupt environments. For example, research suggesting that corruption perceptions provoke resistance and compliance efforts often presumes an unproblematic alignment between ethical awareness and moral action.

Similarly, there is a void in the literature regarding the impact of FIUN on tax fraud in the context of small-sized businesses, particularly in emerging markets. Previous studies predominantly focus on larger firms that typically benefit from established financial systems, robust governance structures, and access to capital markets (e.g. Panagiotidis & Printzis, 2021; Byrne et al., 2016; Grimme & Henzel, 2024). These studies explore how FIUN influences strategic decisions in areas such as risk management, capital allocation, and corporate compliance, emphasising the adaptive mechanisms employed by larger organisations to mitigate financial instability. As explained, firms under financial uncertainty are often shown to defer investments, prioritise short-term liquidity preservation, and adopt more conservative financial strategies to mitigate risks associated with volatile economic conditions. These studies are comprehensive in addressing macro-level and strategic organisational behaviours. However, they tend to focus on larger firms with access to financial systems. As such, they leave significant gaps in understanding the unique challenges faced by small-sized businesses. For instance, others (Hamza et al., 2024) suggest that financial uncertainty often forces small businesses to make immediate survival-driven decisions, such as cutting operational costs, delaying payments, or reallocating resources from compliance-related expenditures to urgent needs. Unfortunately, although these studies highlight the structural vulnerabilities of small businesses under FIUN, they may fail to examine how these pressures might directly contribute to unethical practices, such as tax fraud, as a coping mechanism.

Therefore, the current study extends the tax fraud literature by moving beyond the dominant emphasis on direct structural determinants and examining the cognitive processes through which contextual pressures are transformed into fraudulent behaviour. Rather than introducing moral disengagement as a new predictor of unethical behaviour, this study reconceptualises moral disengagement as a mediating psychological mechanism that explains how corruption perception and financial uncertainty are translated into tax fraud decisions. This study adopts SCT as its theoretical framework to provide a deeper understanding of the cognitive and psychological mechanisms underpinning unethical decision-making (Bandura, 2001). According to Bandura (2001), the SCT suggests that situational factors alone are insufficient to directly determine an individual's decision to engage in specific behaviours. Instead, such behaviours, particularly those with serious consequences, like tax fraud, are mediated by cognitive processes, including moral reasoning and self-regulation as explained in MORD (Bandura, 2001). Under the current study, COPER, for instance, may shape individuals' perceptions of societal norms and the acceptability of unethical behaviour, fostering an environment where tax fraud becomes rationalised. Similarly, FIUN creates a psychological context of financial stress and uncertainty, prompting individuals to seek immediate relief, even if it involves unethical actions. These points emphasise that such situational pressures do not automatically result in tax fraud; rather, they operate through MORD, which allows individuals to disengage from their internalised moral standards and justify deviant behaviours (Takacs Haynes & Rašković, 2021).

Literature Review and Hypotheses Development

Social cognitive theory (SCT)

SCT, initially posited by Albert Bandura, serves as a comprehensive framework for understanding the interplay between individual cognitive processes, environmental influences, and behavioural patterns in shaping human actions (Bandura, 2001; Thomas & Gupta, 2021). If we applied this logic to the context of tax fraud in small-sized businesses in emerging markets, SCT may offer a novel lens through which to dissect the multifaceted dynamics of fraudulent behaviours (Schunk & DiBenedetto, 2020). Practically, emerging markets are often characterised by regulatory inefficiencies, limited tax enforcement, and a pervasive culture of informal practices, which collectively create a fertile ground for tax evasion (Iwasaki et al., 2022). From an SCT perspective, observational learning plays a significant role (Schunk & DiBenedetto, 2020); individuals operating small businesses are influenced by the actions and perceived successes of others within their social milieu who engage in tax fraud. This imitation, compounded by weak regulatory oversight, fosters a normalisation of fraudulent practices, effectively embedding such behaviours into the collective psyche of business networks (Chan et al., 2023). According to Ozyilmaz et al. (2018), the cognitive rationalisations are often reinforced by situational cues, including inconsistent or corrupt tax administration, which diminish the perceived risks of detection and penalties.

Furthermore, a critical application of SCT to TAFR in small-sized businesses is also attributed to the role of self-efficacy and outcome expectations in shaping fraudulent behaviours (Lent et al., 2018; Ozyilmaz et al., 2018). Referring to those studies, high self-efficacy regarding the ability to manipulate financial records or navigate regulatory loopholes can embolden individuals to engage in tax evasion. This confidence is often cultivated through repeated exposure to successful fraudulent practices within their networks, further compounded by a lack of punitive precedents in emerging market contexts. Moreover, outcome expectations, or the anticipated consequences of one's actions, are heavily skewed in environments where tax enforcement is sporadic and penalties are rarely commensurate with the economic gains from evasion (Ngah et al., 2022). Such skewed expectations also create a behavioural feedback loop, wherein successful evasion reinforces the belief that fraud is both feasible and advantageous (Besley & Persson, 2014). Critically, in the work of Schunk and DiBenedetto (2020), SCT also emphasises the role of environmental and policy-level interventions in mitigating such behaviours. We believe that strengthening institutional frameworks, enhancing transparency in tax administration, and fostering a culture of ethical compliance through targeted socialisation and educational campaigns are essential to disrupting the reinforcement mechanisms that perpetuate tax fraud. Therefore, under situating individual behaviours within broader socio-cultural and institutional contexts, SCT is expected to provide a comprehensive understanding of how cognitive, social, and environmental factors converge to sustain tax fraud in small businesses within emerging markets (Lent & Brown, 2019).

COPER and TAFR

Prior studies consistently argue that COPER significantly influences the propensity of small-sized businesses to commit TAFR, framing this relationship within a broader socio-economic and psychological context (Kurauone et al., 2021; Amara & Khlif, 2018). COPER often shapes the external economic and regulatory landscape, creating inefficiencies that disproportionately burden smaller enterprises. According to Kurauone et al. (2021), regulatory frameworks riddled with corruption perceptions often become barriers rather than enablers of business growth, where compliance costs, both legitimate and illegitimate, escalate significantly. Small-sized businesses, which typically operate with constrained financial margins and skeletal organisational structures, are disproportionately burdened by these inefficiencies (Nguyen & Canh, 2021). COPER leads to a distortion of the regulatory environment, where policies and enforcement practices are applied inconsistently, favouring those who can afford to navigate corrupt systems through bribery or political connections. This uneven playing field incentivises tax fraud as a survival mechanism, as smaller enterprises attempt to balance the inequities imposed by systemic corruption (Naradda et al., 2020).

Under this situation, these businesses often face a stark choice between non-compliance and operational stagnation, with TAFR emerging as the lesser of two evils in a hostile economic climate. Moreover, many prior studies emphasise that tax fraud is frequently a pragmatic response to systemic exploitation faced by small-sized enterprises, a perspective grounded in the structural challenges and inequities these businesses encounter (Wong et al., 2018). For many entrepreneurs, the taxation system represents a mechanism of systemic exploitation rather than a tool for equitable public resource distribution (Kogut & Mejri, 2022). In such contexts, small enterprises often experience excessive regulatory burdens, arbitrary enforcement, and demands for illicit payments, creating an operational environment that disproportionately targets their limited resources. The perception that tax money is funnelled into corrupt channels rather than public services exacerbates this exploitation, transforming tax compliance into a symbolic surrender to an unjust system. Based on this explanation, we propose that:
H1: The greater the corruption perception, the higher the likelihood of tax fraud becomes.

COPER and MORD

According to some scholars (Al-Hadi et al., 2022; Khlif & Amara, 2019), as corruption permeates the social fabric, businesses, especially smaller enterprises operating under resource constraints, are increasingly compelled to adapt to the prevailing norms of an unjust system, where survival often hinges on conforming to corrupt practices rather than adhering to ethical standards. It can be argued that in environments where institutional integrity is compromised, businesses are faced with a stark reality (Hearson, 2018). The erosion of trust in both public and private institutions forces businesses to recalibrate their strategies that often prioritise survival over adherence to legal or moral guidelines. This adaptation is not born out of a desire to engage in unethical practices, but rather as a response to the systemic failure that presents compliance as an insurmountable obstacle, one that only serves to further entrench the existing power structures (Ngah et al., 2022). In such contexts, businesses rationalise their involvement in corrupt activities as an unfortunate but necessary means of levelling the playing field. As explained by Bhalla et al. (2022), their actions, consequently, are attributed to the distorted norms that characterise their operational environment.

Furthermore, in such environments, the distinction between right and wrong becomes increasingly blurred. It is because businesses learn to navigate a system where adherence to the law is seen as a weakness or a sign of naivety. So, if competitive pressures mount and the threat of being left behind looms large, businesses may feel compelled to engage in dishonest practices to stay afloat or maintain market share. This normalisation of corruption, driven by survival instincts (Gallegos Mardones et al., 2024), creates a feedback loop where businesses increasingly view TAFR as a necessity rather than a choice, further entrenching the unjust system in which they operate. As such, the more businesses engage in such practices, the more they reinforce the distorted moral landscape, making it harder for ethical conduct to take root in the system. Based on this explanation, we propose that:
H2: The greater the corruption perception, the higher the level of moral disengagement becomes.

FIUN and TAFR

Unlike larger corporations, small businesses are not equipped with the capital reserves, diversified income streams, or good financial networks that can help weather economic downturns or mitigate the effects of financial uncertainty. This vulnerability is expanded by the disproportionate reliance on a narrow client base and often limited access to affordable financing, which increases the risk of liquidity crises (Kim et al., 2021). Consequently, small businesses are more likely to face cash flow challenges, particularly in times of economic instability or fluctuating market demand. These factors coalesce to create an environment where the financial viability of small enterprises is consistently at risk, leading business owners to prioritise immediate survival over long-term financial health or ethical considerations (Ren et al., 2023). In this fragile environment, the temptation to resort to unethical practices, such as tax fraud, becomes more pronounced (Kuckertz, 2021).

Once businesses are struggling to maintain solvency, paying taxes or adhering to rigorous regulatory frameworks can be viewed as burdensome or even unfeasible, given the ongoing pressure to meet operational costs, fulfil payroll obligations, and manage outstanding debts. In such conditions, business owners are more likely to make reactive decisions aimed at preserving the financial health of their business, even if these decisions involve engaging in unethical practices like tax fraud. Once faced with the dual pressures of market volatility and regulatory obligations, tax fraud becomes an alluring option, as it offers immediate financial relief by temporarily reducing tax liabilities (Ngah et al., 2020). Thus, tax fraud emerges as a pragmatic response to the immediate financial pressures faced by small business owners, who perceive evading taxes as a necessary step to safeguard their cash flow and secure the survival of their enterprise. Based on this explanation, we propose that:
H3: The greater the financial uncertainty, the higher the likelihood of tax fraud becomes.

FIUN and MORD

FIUN, defined by unpredictable income streams, volatile market conditions, and a pervasive lack of financial stability, exerts profound psychological and organisational pressures that distort ethical decision-making (Sharma et al., 2018; Kim et al., 2021). In such high-stakes environments, the immediate need to mitigate financial risks often overrides long-term considerations of moral integrity. If faced with the constant threat of insolvency, layoffs, or the inability to meet operational obligations, individuals and business owners recalibrate their priorities to focus on short-term survival (Akpan et al., 2022). This situation, while seemingly pragmatic, creates a cognitive environment where ethical considerations are deprioritised or entirely dismissed. Ethical norms, which require deliberate reflection and adherence to abstract principles (Khan et al., 2021), are perceived as luxuries in scenarios dominated by urgency and scarcity. For instance, a small business owner struggling to maintain cash flow during periods of market volatility may justify underreporting income to the tax authorities by framing it as a necessary action to sustain their employees' livelihoods.

Similarly, entrepreneurs may engage in corrupt practices, such as bribing officials to expedite permits rationalising these actions as unavoidable within a flawed system that hinders legitimate business operations (Al-Hadi et al., 2022). This perception of tax obligations as secondary to immediate survival pressures provides a fertile context for moral disengagement, allowing owners to justify avoiding taxes as a practical response to their precarious financial circumstances. Moreover, the opacity and inefficiencies of tax collection agencies, particularly in regions with weak institutional frameworks, further diminish the perceived legitimacy of tax obligations (Chan et al., 2023). Small business owners may believe that their tax contributions are unlikely to translate into tangible public benefits, thus reinforcing the moral disengagement that facilitates tax avoidance. The diffusion of responsibility (Newman et al., 2020) within this sense further enables such behaviours. It is because individuals absolve themselves of personal accountability by attributing their choices to external factors like systemic inefficiencies or the actions of competitors. This externalisation of blame, coupled with the minimisation of harm, where individuals downplay the consequences of their actions, creates a robust framework for moral disengagement. Based on this explanation, we propose that:
H4: The greater the financial uncertainty, the higher the level of moral disengagement becomes.

MORD and TAFR

MORD, as conceptualised by Newman et al. (2020), operates through a psychological mechanism wherein individuals rationalise unethical actions by altering their perception of morality. As

mentioned earlier, small business owners often operate in challenging economic environments characterised by resource scarcity, regulatory burdens, and intense competition (Ngah et al., 2022). These pressures create conditions where adhering to ethical norms, including tax compliance, may seem impractical or even detrimental to business survival. Moral disengagement, in this context, acts as a psychological enabler (Newman et al., 2020), that allows owners to cognitively restructure their actions and frames TAFR as a rational, justifiable response to external pressures. For instance, owners may diffuse responsibility by blaming systemic inefficiencies or corrupt institutions for their actions. This cognitive reframing may diminish the perceived severity of their actions that enables small business owners to justify their behaviour as an act of self-defence against an unjust system. So, by portraying themselves as victims rather than perpetrators, they effectively shift the moral narrative casting their tax evasion as a rational and even ethical reaction to systemic exploitation (Wong et al., 2018). This psychological strategy can reduce feelings of guilt because the business owner views their actions as a protective measure against a government or system that has failed to uphold its end of the social contract. In this reframing, tax fraud is not viewed as a breach of regulatory compliance but an act of resistance. Based on this explanation, we propose that:
H5: The greater the moral disengagement, the higher the likelihood of tax fraud becomes.

The mediating role of moral disengagement

In the context of small-sized businesses, COPER takes on a particularly acute significance as these businesses are often vulnerable to external economic and regulatory pressures. In such environments, where corruption is seen as endemic, business owners may experience a growing sense that compliance with tax laws is not only futile but counterproductive (Amara & Khlif, 2018). In these circumstances, COPER fosters a climate in which unethical practices such as tax fraud are normalised. Small business owners, who often lack the resources to challenge systemic inefficiencies, may begin to perceive tax compliance as an unjust and inequitable burden that disproportionately benefits corrupt officials and undermines their ability to compete or survive (Bahoo et al., 2020). This perception leads to the view that paying taxes simply feeds into a corrupt system, where the financial resources are misused and provide no tangible benefits to the community or business owners (Amara & Khlif, 2018).

However, according to some scholars (Kurauone et al., 2021), the mere perception of corruption does not automatically result in tax fraud. Without a psychological mechanism to justify such unethical behaviour, business owners may feel the moral weight of evading taxes and thus refrain from engaging in non-compliance. This is where MORD becomes central. It provides the cognitive framework that allows small business owners to reconcile their tax fraud with their self-image and moral beliefs. Through MORD, tax evasion is reframed not as a criminal act but as a necessary response to the perceived systemic failure. For instance, through advantageous comparison (Cheng & Chu, 2014), small business owners may justify their actions by emphasising that their TF is minuscule compared to the large-scale corruption perpetuated by government officials or multinational corporations. Based on this explanation, we propose that:
H6: The greater the corruption perception, the higher the moral disengagement, and the more likely tax fraud becomes.

Similarly, it is very important to examine whether MORD mediates the FIUN-TAFR relationship, especially within the context of small-sized businesses that often operate under high levels of fiscal instability. FIUN, characterised by unpredictable income, fluctuating market conditions, and inconsistent cash flow, creates a stressful environment for business owners (Magerakis & Habib, 2022). Under these conditions, taxes may be seen as an unfair burden imposed by a system that provides little in return for compliance. Then, if the business owner views government institutions or tax authorities as corrupt or inefficient, their perception of paying taxes becomes one of exploitation rather than a civic responsibility (Sharma et al., 2018). This view shows a shift in perspective, where TF is rationalised as an acceptable response to systemic failures. The business owner, feeling that their contributions are squandered or misused, may no longer view tax compliance as an obligation but as a hindrance to their business survival. So, the perception that the taxation system benefits the corrupt rather than the public only strengthens this belief. As a result, evading taxes is framed not as an unethical act, but as a pragmatic and necessary survival strategy in an environment that rewards inefficiency and corruption (Nguyen & Canh, 2021). It is perceived that the primary focus shifts from long-term strategic goals to immediate survival, and business owners are often compelled to make decisions that prioritise short-term financial stability over ethical considerations (Xie et al., 2019). This situation in priorities creates fertile ground for moral disengagement as the pressures of maintaining liquidity and meeting operational costs may lead business owners to rationalise tax fraud as a necessary, albeit temporary, solution to their financial challenges. Based on this explanation, we propose that:

H7: The greater the financial uncertainty, the higher the moral disengagement, and the more likely tax fraud becomes.

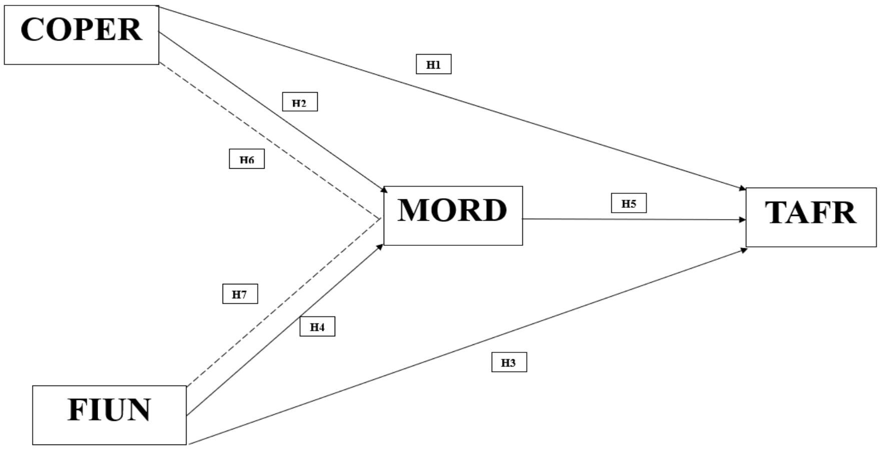

Figure 1. Research Model

Research Methods

Data

We distributed questionnaire to small-sized businesses operating at one of cities in East Java, by employing purposive sampling. This city, known as the most economically advanced city in East Java Province, was chosen deliberately due to its unique socio-political context. Our respondents were carefully selected to meet specific criteria. We focused on business owners. We prioritise individuals who have direct exposure to the operational and financial challenges associated with running small enterprises. Although the sample size of 93 respondents is relatively modest, the adequacy of the sample should be considered in conjunction with the purposive sampling strategy and the characteristics of the respondents. The sample was not intended to statistically represent all small-sized businesses in East Java; rather, it was designed to obtain information-rich responses from business owners who met the predetermined inclusion criteria. Therefore, the findings should be interpreted as reflecting the perspectives of the sampled small-business owners and should not be generalized to the entire population of small-sized businesses without caution.

This research involved 93 owners of small-sized business. In addition to the established sampling criteria, the willingness of business owners to participate significantly shaped the composition of the sample. Many participants recognised the potential implications of the research and approached it with caution. Even though this study used a scenario to stimulate their responses. Accordingly, the sample comprised 63 percent men and 37 percent women. Educational backgrounds varied, with 42 percent holding senior high school qualifications, 36 percent diploma degrees, and 22 percent undergraduate qualifications. We believe that this study offers a spectrum of perspectives on corruption and tax-related behaviours. Notably, 62 percent of participants managed their businesses full-time while 38 percent were part-time managers. Although the sample size is relatively small, its representativeness is enhanced by the demographics of the participants, all of whom are business owners directly involved in managing their enterprises. This targeted selection ensures that the insights gathered are grounded in first-hand experiences and informed perspectives on corruption, financial uncertainty, and tax fraud. Regarding the legal status of the businesses, 54 respondents operated as sole proprietorships, 22 as partnerships (CV/Firm), 17 as limited liability companies (PT). With respect to tax registration, 85 respondents reported that their businesses were registered taxpayers (NPWP), whereas 8 respondents had not yet completed formal tax registration. Among the registered taxpayers, 27 for three to five years, 36 for six to ten years, and 22 for more than ten years. Then 8 respondents did not meet formal tax registration.

Measurements

Given that all constructs were measured using self-reported questionnaires collected from the same respondents at a single point in time, common method bias (CMB) may potentially affect the observed relationships. To minimise this concern, several procedural remedies were implemented during the questionnaire design and administration. Respondents were assured that their responses would remain anonymous and confidential, thereby reducing evaluation apprehension and social desirability bias. Furthermore, the questionnaire emphasised that there were no right or wrong answers and encouraged respondents to answer honestly based on their own experiences.

We developed the items to measure COPER by thoroughly consulting the foundational works of Kurauone et al. (2020) and Doan et al. (2022). This decision allowed us to incorporate validated dimensions of corruption perception, such as the perceived prevalence, normalisation of corrupt practices, and the effectiveness of anti-corruption mechanisms. In grounding our measures in these seminal studies, we ensured that the items reflect both context-specific nuances and generalisable insights that strengthen their applicability to the small business environment in emerging markets. Similarly, we developed the items to measure FIUN from Naradda et al. (2020), tailoring them to capture the operational challenges faced by small enterprises amidst fluctuating economic conditions. The modifications ensured that the measures address key elements of financial instability, such as cash flow unpredictability, exposure to market volatility, and the inability to access affordable credit, which are critical to understanding the behaviours of small business owners under financial stress. To measure MORD, we utilised items developed by Newman et al. (2020). Those items capture the cognitive mechanisms that enable individuals to rationalise unethical behaviour. For instance, these items were carefully selected to reflect dimensions such as blame-shifting, minimisation of consequences, and dehumanisation (Newman et al., 2020). Finally, Items to measure TAFR was developed from the works of Torgler (2008) and de La Feria, R. (2020). All items are rated by respondents by using a 5 likert-scale. Detailed measurement items for all constructs are provided in Appendix A.

Data analysis

The data were analysed using partial least squares structural equation modelling (PLS-SEM). As mentioned by Hair et al. (2019), this approach is suitable for complex research models that include mediation relationships and latent variables measured with multiple indicators. PLS-SEM works well with predictive research objectives and does not require strict normal distribution assumptions (Hair et al., 2019), which makes it appropriate for behavioural studies involving small-sized businesses. The analysis was conducted in two main stages: evaluation of the measurement model and evaluation of the structural model. In the first stage, the measurement model was assessed to ensure that all constructs were reliable and valid. Indicator reliability was examined through outer loadings, while internal consistency reliability was assessed using Cronbach's alpha and composite reliability. Convergent validity was evaluated using the average variance extracted (AVE), and discriminant validity was tested using the Fornell-Larcker Criterion, and HTMT criterion. These procedures ensure that each construct accurately measures its intended concept and remains clearly distinct from other constructs in the model (Hair et al., 2019). After confirming the adequacy of the measurement model, the structural model was assessed to examine the relationships among corruption perception, financial uncertainty, moral disengagement, and tax fraud. The evaluation involved analysing path coefficients, coefficients of determination (R^2), and predictive relevance. A bootstrapping procedure with resampling was applied to test the significance of the hypothesised paths and mediation effects. This method allows for robust estimation of indirect effects and provides stronger confidence in the stability of the findings. In addition, collinearity diagnostics were checked to ensure that the predictor constructs did not create bias in the regression estimates.

Results and Discussion

Measurement model assessment

For the assessment of the measurement model, we adhered to the guidelines proposed by Hair et al. (2019), focusing on both convergent and discriminant validity analyses. The outcomes of the convergent validity evaluation are detailed in Tables 1 and 2. In contrast, the findings from the discriminant validity analysis are comprehensively outlined in Tables 3, 4, and 5. The data in Table 1 indicate that all loading values are above the acceptable threshold of 0.5, supporting the reliability of the measurement items. The VIF values indicate that there is no issue with multicollinearity. Moreover, the weights of the items are varied but contribute meaningfully to their respective constructs, reinforcing the validity of the model. The results in Table 2 show that all constructs meet reliability and validity criteria. Cronbach's Alpha and composite reliability values exceed the recommended threshold of 0.7, indicating good internal consistency. The AVE values for most constructs are above 0.5, confirming convergent validity. So, in general, the constructs demonstrate satisfactory reliability and validity.

Table 1. Loading, Weights and VIF

Measurement items	Loading	Weights	VIF
COPER 1	0.728	0.383	1.437
COPER 2	0.779	0.316	1.919
COPER 3	0.882	0.327	2.408
COPER 4	0.756	0.247	1.829
FIUN 1	0.822	0.237	2.085
FIUN 2	0.858	0.258	2.427
FIUN 3	0.943	0.315	5.573
FIUN 4	0.940	0.305	5.378
MORD 1	0.728	0.289	1.834
MORD 2	0.896	0.354	3.236
MORD 3	0.737	0.407	1.276
MORD 5	0.729	0.237	1.942
TAFR 1	0.836	0.327	2.507
TAFR 2	0.705	0.253	1.790
TAFR 3	0.784	0.354	1.651
TAFR 4	0.595	0.225	1.384
TAFR 5	0.630	0.217	1.522

Source: Processed by authors

Table 2. Construct Reliability and Validity

Variables	Cronbach's Alpha	rho_A	Composite Reliability	AVE
COPER	0.798	0.804	0.867	0.622
MORD	0.780	0.799	0.857	0.602
FIUN	0.914	0.930	0.940	0.796
TAFR	0.758	0.789	0.838	0.512

Source: Processed by authors

Based on the discriminant validity assessment presented in Table 3, all constructs satisfy both the Fornell-Larcker and Heterotrait-Monotrait Ratio (HTMT) criteria. Under the Fornell-Larcker criterion, the square root of the average variance extracted (AVE) for each construct (COPER = 0.789, MORD = 0.776, FIUN = 0.892, and TAFR = 0.716) exceeds its correlations with the other constructs, indicating that each construct shares greater variance with its own indicators than with other latent variables. This finding is further supported by the HTMT results, where all inter-construct values are below the recommended threshold of 0.90, with the highest value being 0.685 between FIUN and TAFR. Collectively, these results confirm that the measurement model demonstrates adequate discriminant validity, suggesting that each construct is empirically distinct and appropriately captures its intended conceptual domain, thereby supporting the suitability of the measurement model for subsequent structural model analysis.

Table 3. Discriminant Validity

Variables	COPER	MORD	FIUN	TAFR
Fornell-Larcker Criteria				
COPER	0.789			
MORD	0.283	0.776		
FIUN	0.189	0.072	0.892	
TAFR	0.134	0.319	0.585	0.716
Heterotrait-Monotrait Ratio (HTMT) Criteria				
COPER				
MORD	0.325			
FIUN	0.226	0.087		
TAFR	0.162	0.399	0.685	

Source: Processed by authors

Based on the model fit assessment presented in Table 4, the structural model demonstrates an acceptable level of fit. The standardized root mean square residual (SRMR) value is 0.082 for both the saturated and estimated models, indicating an acceptable fit as it falls below the recommended threshold of 0.10. The discrepancy measures (d_ULS = 1.025 and d_G = 0.418) indicate a reasonable level of model-data consistency, while the Chi-square value of 212.682 is reported for completeness, although it is not considered a primary criterion for evaluating model fit in PLS-SEM. Furthermore, the normed fit index (NFI) of 0.753 suggests a moderate model fit, which is considered acceptable given the exploratory nature of PLS-SEM, the relatively small sample size, and the complexity of the proposed model. Overall, these results indicate that the structural model exhibits an adequate fit to the observed data and is appropriate for subsequent hypothesis testing.

Table 4. Model Fitness

	Saturated Model	Estimated Model
SRMR	0.082	0.082
d_ULS	1.025	1.025
d_G	0.418	0.418
Chi-Square	212.682	212.682
NFI	0.753	0.753

Source: Processed by authors

Coefficient of determination (R^2)

The coefficient of determination (R^2) was assessed to evaluate the explanatory power of the structural model. R^2 indicates the proportion of variance in an endogenous construct that can be explained by its predictor constructs. As presented in Table X, the R^2 value for MORD is 0.081, with an adjusted R^2 of 0.060. This indicates that COPER and FIUN collectively explain approximately 8.1% of the variance in MORD, while the remaining variance is attributable to other factors not included in the proposed model.

Meanwhile, the R^2 value for TAFR is 0.422, with an adjusted R^2 of 0.403. This indicates that COPER, FIUN, and MORD collectively explain approximately 42.2% of the variance in TAFR, while the remaining variance is explained by other factors outside the research model. Overall, these findings provide evidence regarding the explanatory power of the proposed structural model in explaining the endogenous constructs.

Table 5. Coefficient of Determination (R^2)

Endogenous Construct	R^2	Adj. R^2
MORD	0.081	0.060
TAFR	0.422	0.403

Source: Processed by authors

Hypothesis testing

According to Table 6, the path from COPER to TAFR (H1) shows a negative path coefficient (β) of -0.058, with a t-statistic of 0.586 and a significance value of 0.563, which is greater than the 0.05 threshold. Therefore, H1 is not supported. The relationship between COPER and MORD (H2) is positive, with a β value of 0.280, a t-statistic of 2.667, and a significance value of 0.008, which is below the 0.05 threshold. Thus, H2 is supported. For the path from FIUN to TAFR (H3), the β value is 0.575, with a t-statistic of 7.278 and a significance value of 0.000, indicating a positive and statistically significant relationship. Therefore, H3 is supported. Conversely, the path from FIUN to MORD (H4) has a β value of 0.019, a t-statistic of 0.167, and a significance value of 0.870, which is above the 0.05 threshold. Accordingly, H4 is not supported. Finally, the path from MORD to TAFR (H5) shows a positive β value of 0.294, with a t-statistic of 3.542 and a significance value of 0.000, indicating a statistically significant positive relationship. Thus, H5 is supported. Overall, the results indicate that H2, H3, and H5 are supported, whereas H1 and H4 are not supported based on the path coefficients and significance levels.

Table 6. Direct Effects

Paths	β	T-Statistics	SD	Sig.	Notes
H1: COPER → TAFR	-0.058	0.586	0.099	0.563	Not Supported
H2: COPER → MORD	0.280	2.667	0.105	0.008	Supported
H3: FIUN → TAFR	0.575	7.278	0.079	0.000	Supported
H4: FIUN → MORD	0.019	0.167	0.114	0.870	Not Supported
H5: MORD → TAFR	0.294	3.542	0.083	0.000	Supported

Source: Processed by authors

Furthermore, Table 7 presents the indirect effects in the structural model and examines the mediating role of MORD. The indirect effect of COPER on TAFR through MORD (H6) has a β value of 0.082, a t-statistic of 2.103, and a significance value of 0.033, which is below the 0.05 threshold. Therefore, the indirect effect is statistically significant, and H6 is supported. In contrast, the indirect effect of FIUN on TAFR through MORD (H7) has a β value of 0.006, a t-statistic of 0.167, and a significance value of 0.877, which is above the 0.05 threshold. Hence, the indirect effect is not statistically significant, and H7 is not supported. These findings indicate that MORD significantly mediates the relationship between COPER and TAFR, but does not significantly mediate the relationship between FIUN and TAFR.

Table 7. Indirect Effects

Paths	β	T-Statistics	SD	Sig.	Note
H6: COPER → MORD → TAFR	0.082	2.103	0.039	0.033	Supported
H7: FIUN → MORD → TAFR	0.006	0.167	0.036	0.877	Not Supported

Source: Processed by authors

Discussion

This research seeks to explore the impact of COPER and FIUN on TAFR, with a particular focus on whether MORD mediates these relationships. Distinctively, this research centres on small-sized businesses operating within an emerging economy, using the SCT (Bandura, 2001). Equally significant is that this study relies exclusively on the perspectives of business owners. As such, this is expected to offer fresh and valuable insights into a context often underexplored in the literature.

Our study suggests that COPER do not directly correlate with TAFR but exert an indirect effect mediated through MORD. This is a critical challenge to the prevailing assumptions about the relationship between systemic corruption and individual fraudulent behaviour (Kurauone et al., 2020; Ullah, 2020). The dominant discourse often oversimplifies this relationship that a direct causal link between heightened corruption awareness and increased likelihood of unethical tax behaviour (Bani-Mustafa et al., 2024). For instance, research rooted in transparency and compliance theories often posits that corruption perceptions directly undermine trust in institutions and thereby increase unethical practices (Epstein & Gang, 2024; Tonetto et al., 2024). One critical flaw in these approaches is their inability to capture the variability in individual responses to corruption awareness. While some individuals may react with disillusionment and non-compliance, others might become resigned, normalising corruption as an unavoidable aspect of the socio-political environment. These divergent reactions challenge the assumption of a uniform causal pathway and highlight the importance of intermediary cognitive processes, such as moral disengagement (Bandura, 2001), that shape how individuals interpret and act upon corruption perceptions.

Our study provides compelling evidence that COPER serves as a significant precursor to MORD, which in turn facilitates TAFR. It suggests that when taxpayers perceive corruption as pervasive and systemic, it shapes their worldview that fosters a sense of normative acceptance or inevitability about unethical behaviour. We propose that this perception acts as an environmental cue that undermines conventional moral standards. Consequently, it creates fertile ground for MORD mechanisms to activate. In this sense, of course, COPER introduces a cognitive dissonance between societal expectations and personal moral codes, which individuals resolve by engaging in moral disengagement processes such as moral justification, displacement of responsibility, or minimising the consequences of their actions (Bandura, 2001; Newman et al., 2020). Clearly, our study shows that COPER significantly triggers these mechanisms that perceptions of systemic corruption are not inert or static but actively shape cognitive processes. This finding is consistent with research suggesting that individuals in environments characterised by high corruption often experience a weakening of their ethical resolve (Doan et al., 2022), as they perceive systemic corruption as a normative or unavoidable reality (Ben Othman et al., 2024). Such perceptions, therefore, lead to an erosion of moral standards, allowing MORD to emerge as a powerful cognitive intermediary. From these results we believe that this unique pathway suggests the necessity of revisiting and refining theoretical models to include intermediary cognitive mechanisms, as individuals, as explained by Bandura (2001) do not passively translate their perceptions of corruption into fraudulent acts.

The situation is different when the situational factor is not attributed to macro-level constructs like systemic corruption perceptions. Unlike COPER, which requires a cognitive intermediary like MORD to rationalise unethical behaviour, FIUN directly correlates to TAFR without the need for MORD. FIUN, as an acute and tangible stressor (Naradda et al., 2020), bypasses the cognitive rationalisations typically associated with MORD. This suggests that the urgency of financial strain prompts immediate action rather than prolonged moral deliberation. Conceptually, FIUN does not inherently create moral conflict. The pressure of FIUN is rooted in economic realities rather than ethical ambiguities (Naradda et al., 2020; Engidaw, 2022). So that it leads individuals to view TAFR as a functional necessity rather than a morally contentious act. Since there is little ethical conflict to resolve, the psychological need for MORD as a rationalisation tool diminishes. Businesses facing FIUN are likely to justify TAFR as a “practical solution” to an external economic problem rather than engaging in cognitive processes to morally justify their actions (Kogut & Mejri, 2022). As such, it, in this context, demonstrates that TAFR is not solely a product of moral rationalisation, but emerges in response to acute financial pressures where the primary concern is survival, not moral justification. This insight expands the TAFR literature by showing that situational factors that are externally focused and directly linked to an individual or business’s immediate economic well-being can lead to noncompliance without engaging the complex cognitive processes that MORD typically requires. Therefore, these results highlight the context-dependent nature of cognitive mechanisms in unethical decision-making, where systemic and immediate pressures exert distinct influences on behaviour.

Conclusion and Implications

This study demonstrates that COPER does not directly influence TAFR. However, its effect on TAFR is operated through the cognitive intermediary of MORD. This result dismantles simplistic causality models that equate corruption awareness with deviant behaviour. Simultaneously, the research highlights the direct influence of FIUN on TAFR, bypassing cognitive rationalisations, as economic strain drives immediate, pragmatic decisions to ensure survival. The results further emphasise the context-dependent nature of unethical decision-making, where macro-level systemic corruption and micro-level financial pressures exert distinct yet complementary effects. Through advancing this understanding, the study not only provides a critical lens for future research but also offers actionable insights for regulatory and policy interventions, advocating for an integrative approach that addresses cognitive rationalisations, alleviates economic pressures, and strengthens ethical infrastructures in vulnerable contexts. This perspective broadens the discourse on compliance, moving beyond deterministic models to a richer, more dynamic account of the factors shaping tax fraud in emerging economies.

Despite these contributions, this study has several limitations that should be acknowledged. First, the cross-sectional research design restricts the ability to establish causal relationships among the proposed constructs, as the findings capture taxpayer perceptions at a single point in time. Second, the study focuses exclusively on SMEs in Indonesia, which may limit the generalisability of the findings to other institutional and economic settings characterised by different levels of corruption perception and financial uncertainty. Third, the study examines only moral disengagement as the underlying psychological mechanism linking corruption perception to tax fraud. Future research may extend this framework by incorporating other cognitive or emotional mechanisms, such as ethical climate, perceived fairness, moral identity, or trust in government, while also employing longitudinal or cross-country designs to validate and expand the robustness of the proposed model.

The findings yield several managerial implications for both policymakers aiming to mitigate TAFR and enhance ethical compliance. First, the indirect pathway between COPER and TAFR mediated by MORD highlights the need for interventions targeting cognitive processes rather than merely addressing perceptions of corruption. Efforts should focus on disrupting the activation of MORD mechanisms, through targeted education, ethical training, and reinforcement of personal accountability among taxpayers. Second, since COPER fosters an environment where unethical behaviour becomes normalised, policymakers must prioritise transparency and anti-corruption campaigns that emphasise the collective consequences of systemic corruption while reinforcing ethical norms. Anti-corruption campaigns should go beyond promoting transparency and institutional trust; they must actively address the psychological normalisation of unethical behaviour in corrupt environments.

Third, addressing FIUN as a direct driver of TAFR requires targeted economic policies that alleviate financial pressures on businesses. Policymakers should prioritise providing small-sized enterprises with access to affordable credit, tax relief programs, or temporary subsidies during periods of economic hardship. These measures reduce the immediate financial strain that compels businesses to view TAFR as a survival mechanism. Additionally, tax systems must be simplified and made more equitable to prevent the perception that compliance is burdensome or punitive, which can exacerbate the inclination toward noncompliance. Finally, policymakers must adopt a context-sensitive approach, recognising that systemic corruption and acute financial pressures require distinct but complementary solutions. This approach ensures that policies address both the cognitive rationalisations underlying TAFR in environments with high COPER and the situational pressures stemming from FIUN. By integrating psychological, economic, and institutional dimensions into anti-TAFR strategies, policymakers can foster a compliance-driven culture that simultaneously tackles the root causes of tax fraud and its enabling mechanisms.

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Appendix A

Variables	Code	Measurement Item
Corruption Perception (COPER)	COPER1	Corrupt practices are common in government agencies dealing with business taxation.
	COPER2	Businesses often need unofficial payments or personal connections to resolve tax-related matters.
	COPER3	Honest businesses are disadvantaged when corruption is widespread.
	COPER4	Anti-corruption efforts in tax administration are generally ineffective.
Financial Uncertainty (FIUN)	FIUN1	My business often faces uncertainty in generating sufficient income to cover operational costs.
	FIUN2	Changes in market conditions make it difficult to predict the financial performance of my business.
	FIUN3	Maintaining stable cash flow has become increasingly difficult for my business.
	FIUN4	Financial uncertainty makes it difficult to plan the future of my business.
Moral Disengagement (MORD)	MORD1	Avoiding certain tax obligations can be justified when the business is under severe financial pressure.
	MORD2	If the government does not use tax money properly, businesses can justify reducing their tax payments.
	MORD3	Under certain circumstances, breaking tax rules is understandable if it helps keep a business operating.
	MORD4	If many other businesses avoid taxes, it is difficult to blame one business for doing the same.
	MORD5	Businesses should not feel entirely responsible for avoiding taxes when the tax system is unfair.
Tax Fraud (TAFR)	TAFR1	Some businesses intentionally underreport income to reduce tax obligations.
	TAFR2	Businesses may omit certain transactions from financial reports to lower taxes.
	TAFR3	Manipulating financial information to reduce tax payments is sometimes viewed as a practical business strategy.
	TAFR4	Businesses may claim expenses that are not fully legitimate to reduce taxable income.
	TAFR5	When tax enforcement is weak, businesses are more likely to engage in tax fraud.

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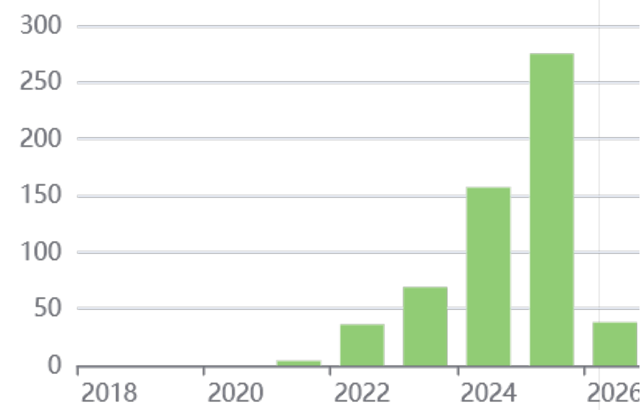

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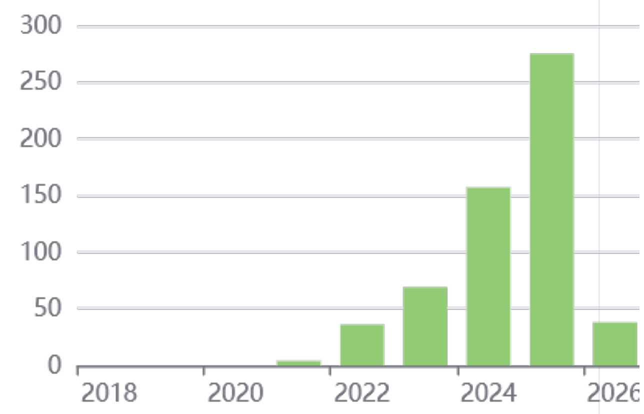

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