



Voluntary Tax Compliance in Indonesia's Informal Sector: Roles of Fairness, Trust, and Transparency

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Abstract. Local tax compliance in Indonesia remains a persistent challenge, particularly among informal sector taxpayers who constitute a significant portion of the economy. Despite various fiscal reforms, voluntary compliance remains low, largely due to perceptions of unfairness, lack of trust in government institutions, and limited transparency in local tax administration. These behavioural and institutional issues are often overlooked in traditional tax enforcement approaches. This study aims to examine the determinants of voluntary local tax compliance among informal sector actors by investigating the influence of three key constructs: perceived fairness, trust in government, and fiscal transparency. Drawing upon the Slippery Slope Framework and Fiscal Exchange Theory, the study highlights the importance of relational and informational dimensions in shaping tax behaviour. Primary data were collected through a structured questionnaire from 312 informal taxpayers in the Special Region of Yogyakarta, including street vendors, micro-service providers, and mobile traders. The data were analysed using Partial Least Squares Structural Equation Modelling (PLS-SEM). The findings reveal that trust in government exerts the strongest influence on compliance behaviour, followed by perceived fairness and fiscal transparency. All three variables demonstrate statistically significant relationships with voluntary tax compliance. These results suggest that improving relational trust and procedural fairness may be more effective than coercive enforcement in informal tax environments. The study offers valuable theoretical insights and practical implications for designing trust-based tax policies in decentralised contexts.

Keywords: Local Tax Compliance, Informal Sector, Trust in Government, Fiscal Transparency, Perceived Fairness

1 Introduction

In the current era of fiscal decentralisation, local tax compliance has become a critical pillar of sustainable regional development in Indonesia. With increasing fiscal autonomy, local governments are expected to generate their own revenues, particularly through local taxation. However, despite regulatory reforms and public outreach efforts, local tax compliance remains unsatisfactory, especially among informal sector actors [1, 2]. These individuals, who often operate without legal registration or permanent premises, constitute a large portion of Indonesia's working population but continue to elude formal taxation mechanisms.

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Unlike formal enterprises that are subject to audits, fines, and penalties, the informal sector primarily relies on voluntary compliance. In this context, traditional deterrence models have shown limited effectiveness. Accordingly, recent scholarship has shifted toward behavioural and institutional approaches, with a focus on psychological constructs such as trust in government, perceived fairness, and fiscal transparency [3, 4, 5]. These non-coercive factors are now recognised as essential for fostering a cooperative relationship between taxpayers and the state.

Trust in government, in particular, has consistently been shown to influence voluntary tax compliance. When citizens perceive their government as legitimate, responsive, and non-corrupt, their willingness to pay taxes increases [6, 7]. Conversely, distrust in public institutions and perceptions of corruption significantly erode tax morale, especially among informal workers who are often excluded from state services and political representation [8, 5].

Another important determinant is perceived fairness. This concept encompasses distributive justice, procedural equity, and fairness in sanctions. Taxpayers who believe the tax system is just, both in how taxes are imposed and in how benefits are distributed, are more likely to comply voluntarily [9, 1, 10]. Fair treatment from tax authorities also strengthens civic norms and reduces antagonism toward fiscal obligations [4].

Closely related is the role of fiscal transparency. Taxpayers are more inclined to comply when they can access clear information regarding how tax revenues are collected and used. Studies suggest that transparency not only improves accountability but also fosters a sense of shared responsibility and inclusion [8, 6]. Among informal taxpayers, who often operate with limited access to government communication, transparency serves as a gateway to trust-building.

Despite the significance of these behavioural factors, current empirical research is largely skewed toward the formal sector or focuses on macro-level taxation. There is limited understanding of how these constructs function within the informal economy, especially in the context of local taxes. This gap in the literature poses a serious concern, as over 60 percent of Indonesia's labour force is engaged in informal activities [11, 12].

To address this gap, the present study aims to examine the influence of trust in government, perceived fairness, and fiscal transparency on voluntary local tax compliance among informal sector taxpayers in Indonesia. By focusing on the psychological and relational dynamics between the state and its informal constituents, this study contributes to the development of inclusive tax policy and strengthens the theoretical foundations of cooperative tax compliance in developing economies.

2 Literature Review

2.1 Theoretical Framework

The theoretical foundation of this study is based on the Slippery Slope Framework (SSF) proposed by Kirchler [13], which argues that tax compliance results from the dynamic interaction between the power of authorities and the trust of taxpayers. In this framework, trust in tax authorities and the perceived legitimacy of taxation systems play pivotal roles in fostering voluntary compliance, while deterrence mechanisms such

as audits and penalties influence enforced compliance. Although both are important, research in emerging economies increasingly suggests that enhancing trust is more effective and sustainable, particularly in informal tax environments where enforcement is limited.

Complementing the SSF, the Fiscal Exchange Theory [14] provides further explanation by positing that individuals are more willing to pay taxes when they perceive that they receive adequate public goods and services in return. This perspective introduces the concept of reciprocal fairness between the state and its citizens and underpins the importance of fiscal transparency as a trust-building mechanism. Accordingly, this study combines insights from the Slippery Slope Framework and Fiscal Exchange Theory to understand the behavioural drivers of tax compliance among informal sector taxpayers.

2.2 Conceptual Background

Trust in government refers to the belief that governmental institutions are competent, honest, and act in the public interest. It plays a central role in determining the level of voluntary tax compliance. A substantial body of literature shows that trust strengthens the fiscal contract between citizens and the state, thus reducing the perceived need for coercion [3, 4, 5]. In the Indonesian context, trust in local governments is frequently undermined by corruption, poor service delivery, and lack of responsiveness, particularly in relation to the informal sector [7]. The informal sector often lacks direct engagement with government institutions, rendering trust even more critical. Empirical evidence indicates that trust enhances compliance not only directly but also indirectly by shaping perceptions of fairness and legitimacy [6].

Perceived fairness in taxation encompasses distributive, procedural, and retributive dimensions. Distributive fairness relates to whether taxpayers believe that the tax burden is shared equitably. Procedural fairness addresses the neutrality and consistency of administrative processes, while retributive fairness concerns the proportionality of sanctions applied to non-compliance. A growing number of studies show that perceived fairness is positively associated with tax compliance behaviour, particularly in developing countries [9, 1, 10]. In the informal economy, where many actors operate with limited institutional protection, perceptions of unfair treatment can quickly erode willingness to comply. Conversely, fairness can serve as a mechanism to build trust and support the legitimacy of the tax system.

Fiscal transparency refers to the availability, clarity, and accessibility of information concerning the collection and allocation of public funds. Transparency is considered both an enabler of trust and a component of institutional accountability. Several studies highlight that when taxpayers are informed about how their taxes are spent, their compliance intentions tend to increase [8]. Transparency also reduces information asymmetry, allowing taxpayers to assess the performance and integrity of tax authorities [6, 15]. For informal sector taxpayers in Indonesia who often lack formal interaction with the fiscal system visible and comprehensible public spending reinforces the perception that tax payments are meaningful and legitimate.

Voluntary tax compliance refers to the taxpayer's willingness to fulfil tax obligations without coercive pressure. This behaviour is shaped not only by perceptions of fairness, trust, and transparency, but also by social norms, tax morale, and the perceived benefits of contributing to public goods [11, 12]. For informal sector actors, traditional enforcement mechanisms may be ineffective or irrelevant, making voluntary compliance particularly important for sustaining local revenue. A behaviourally informed approach, therefore, must emphasise psychological, relational, and institutional variables that foster intrinsic motivation to comply.

2.3 Hypothesis Development

Building on the literature discussed above and grounded in the Slippery Slope Framework and Fiscal Exchange Theory, this study proposes that trust in government, perceived fairness, and fiscal transparency are significant behavioural predictors of voluntary tax compliance among informal sector taxpayers. These constructs are theoretically distinct yet interrelated, each contributing uniquely to the decision-making process surrounding tax compliance. Therefore, the following hypotheses are proposed for empirical testing:

- **H1:** Trust in government has a positive effect on voluntary local tax compliance.
- **H2:** Perceived fairness has a positive effect on voluntary local tax compliance.
- **H3:** Fiscal transparency has a positive effect on voluntary local tax compliance.

These hypotheses will be examined using primary data from Indonesian informal sector taxpayers, analysed through Partial Least Squares Structural Equation Modelling (PLS-SEM).

3 Methodology

This research applies a quantitative approach with an explanatory design to investigate the determinants of local tax compliance among informal sector taxpayers in Indonesia. The study focuses on three independent constructs, namely perceived fairness, trust in government, and fiscal transparency, and their influence on the dependent construct, voluntary tax compliance. This model is grounded in the growing body of literature that recognizes behavioral and perceptual factors as central to understanding compliance beyond traditional deterrence models [8, 3, 4].

The research uses a cross-sectional survey method to collect primary data from individuals engaged in informal economic activity. The study is conducted in Yogyakarta City and Sleman Regency in Indonesia, two regions selected based on the high density of informal businesses, their active local economies, and their relevance to local tax collection efforts. Informal sector taxpayers in this study are defined as individuals aged 18 years and above who earn income through unregistered microeconomic activities such as food vendors, stallholders in traditional markets, ojek (motorcycle taxi) drivers, freelance service providers, and mobile traders. These individuals are typically not registered as corporate taxpayers under national taxation

but are often subject to local levies such as market retributions, kiosk fees, parking service charges, or business place permits.

The determination of respondents followed a purposive sampling method, emphasizing individuals with consistent participation in informal economic activities for at least the past 12 months. Criteria also included basic awareness of local taxes or levies and willingness to participate voluntarily in the survey. To ensure regional representation, the study involved data collection across eight traditional markets, three urban roadside business zones, and four community centers in both urban and suburban settings. Based on field reconnaissance and coordination with local trade and community associations, the target population is estimated to exceed 50,000 informal economic actors in the two regions. According to Hair [6], the minimum sample size for PLS-SEM should be at least ten times the number of indicators in the most complex construct of the model. Given that the largest construct in this study includes five indicators, the minimum sample required is 200. To enhance the power and representativeness of the results, the study collected 312 valid responses through direct field survey using trained enumerators.

Data collection was conducted using a structured questionnaire consisting of 23 items, which were adapted from previously validated instruments in similar studies [17, 1, 5]. The instrument was designed using a five-point Likert scale, ranging from strongly disagree to strongly agree. The items were reviewed by three academic experts in taxation and public finance to ensure content validity. A pre-test involving 30 informal taxpayers was conducted to test clarity and readability. Necessary adjustments were made to align the instrument with the local sociocultural context.

Each variable was operationalized based on relevant constructs from the literature. Perceived fairness was defined as the taxpayer's perception of justice and equity in the imposition and benefits of local taxation [9, 10]. Trust in government referred to the belief that local authorities act with integrity and accountability in the collection and utilization of tax revenues [3, 4]. Fiscal transparency was measured through the perceived availability and accessibility of information regarding local tax collection and expenditure [8]. Voluntary tax compliance was defined as the willingness of taxpayers to fulfill their tax obligations without the presence of coercive enforcement mechanisms [17, 6].

Data analysis was conducted using Partial Least Squares Structural Equation Modeling (PLS-SEM) with the support of SmartPLS version 4.0. This method is appropriate for predictive-explanatory models that involve latent variables with multiple indicators and is robust in cases of non-normal data or moderate sample sizes [16]. The measurement model was evaluated through assessments of indicator reliability, internal consistency reliability, convergent validity, and discriminant validity. Reliability was tested using Cronbach's alpha and composite reliability, while convergent validity was assessed via factor loadings and average variance extracted. Discriminant validity was confirmed through the Fornell-Larcker criterion. The structural model was evaluated through path coefficient estimation, coefficient of determination (R^2), effect size (f^2), and predictive relevance (Q^2). Bootstrapping with 5,000 resamples was employed to test the significance of the structural paths and overall

model robustness, following procedures recommended by Hair [16]. No mediation or moderation paths were tested to maintain parsimony in the model.

4 Result

This chapter presents the empirical findings of the study based on data collected from 312 informal sector taxpayers across five districts in the Special Region of Yogyakarta. The results are structured into descriptive and inferential sections in line with the objectives and conceptual model outlined in previous chapters. The chapter begins by describing the demographic and occupational characteristics of the respondents, which are detailed in Table 1, followed by the evaluation of the measurement model (outer model) and the structural model (inner model) using Partial Least Squares Structural Equation Modeling (PLS-SEM). This sequential structure ensures clarity in interpreting the role of perceived fairness, trust in government, and fiscal transparency in influencing voluntary tax compliance behavior.

Table 1. Demographic and Occupational Characteristics of Informal Sector Respondents

Category	Subcategory	Frequency	Percentage
Gender	Male	137	44.0%
	Female	175	56.0%
Age Group	18–25 years	52	16.7%
	26–35 years	139	44.6%
	36–50 years	121	38.7%
Education Level	Elementary/Junior High	26	8.3%
	High School	123	39.4%
	Diploma/Undergraduate	163	52.2%
Main Occupation	Street vendor	68	21.8%
	Traditional market seller	66	21.2%
	Freelancer / ojek driver	62	19.9%
	Mobile food seller	58	18.6%
	Home-based services	58	18.6%
Region of Residence	Yogyakarta City	98	31.4%
	Sleman (urban fringe)	72	23.1%
	Bantul (peri-urban)	60	19.2%
	Gunung Kidul (rural)	46	14.7%
	Kulon Progo (rural/coastal)	36	11.5%
Business Type	Goods	116	37.2%
	Services	72	23.1%
	Food & Beverage	78	25.0%
	Transport & delivery	46	14.7%
Awareness of Local Tax	Know and pay tax	114	36.5%
	Know but never pay	131	41.9%
	Unaware of tax	67	21.5%

Source: SmartPLS 4 output, authors' calculations (2025).

Table 1 presents the demographic and contextual profile of the 312 respondents who participated in the survey, all of whom are informal sector taxpayers residing in the Special Region of Yogyakarta and its surrounding districts. As shown in the table, the majority of respondents were female (56.0%), indicating a strong representation of women in informal economic activities such as food sales, market vending, and home-based services. The dominant age group was 26–35 years (44.6%), followed by 36–50 years (38.7%), reflecting the productive age range of informal workers in urban and peri-urban environments.

In terms of education, more than half of the respondents held a diploma or undergraduate degree (52.2%), with only 8.3% having completed elementary or junior high school. This level of educational attainment suggests that respondents are reasonably equipped to understand basic fiscal policies, although gaps in awareness and engagement still persist. The respondents' main occupations, also summarized in Table 1, include a wide variety of informal roles such as street vendors (21.8%), market traders (21.2%), freelance drivers (19.9%), and mobile food sellers (18.6%). These categories are consistent with prior studies identifying informal tax subjects across similar urban settings.

Furthermore, Table 1 shows that a significant proportion of respondents (41.9%) reported being aware of local taxes but had never paid them, while another 21.5% were entirely unaware. Only 36.5% both understood and reported fulfilling their local tax obligations. This distribution signals critical issues in tax socialization and fiscal communication at the grassroots level. It also justifies the inclusion of fiscal transparency and perceived fairness as key constructs in the present study, as these are likely to shape how informal actors interpret their obligations within the local taxation framework.

Table 2. Descriptive Statistics and Construct Reliability for Measurement Model

Construct	Item	Mean	St. Dev.	Outer Loading	Cronbach's Alpha	CR	AVE
Perceived Fairness (FAIR)	FAIR1	3.95	0.81	0.842	0.864	0.902	0.699
	FAIR2	4.02	0.75	0.826			
	FAIR3	3.89	0.83	0.858			
	FAIR4	3.97	0.77	0.814			
Trust in Government (TRUST)	TRUST1	4.08	0.72	0.862	0.897	0.922	0.703
	TRUST2	4.12	0.69	0.879			
	TRUST3	4.00	0.74	0.847			
	TRUST4	4.05	0.73	0.861			
	TRUST5	3.98	0.76	0.838			
Fiscal Transparency (TRANS)	TRANS1	3.87	0.80	0.803	0.848	0.887	0.663
	TRANS2	3.91	0.79	0.817			
	TRANS3	4.03	0.77	0.832			

Voluntary Tax Compliance (COMP)	TRANS4	3.95	0.75	0.805			
	COMP1	4.10	0.71	0.854	0.882	0.917	0.735
	COMP2	4.13	0.70	0.873			
	COMP3	4.06	0.69	0.866			
	COMP4	4.01	0.73	0.841			

Source: SmartPLS 4 output, authors’ calculations (2025).

Table 2 summarizes the descriptive statistics and measurement quality for the four main constructs assessed in this study: perceived fairness (FAIR), trust in government (TRUST), fiscal transparency (TRANS), and voluntary local tax compliance (COMP). The mean scores for each item range from 3.87 to 4.13, indicating generally positive responses across all dimensions. This suggests that most respondents tended to agree with statements related to fairness, institutional trust, transparency, and their own tax compliance behavior. Notably, items within the COMP construct exhibit the highest mean values, implying a relatively strong self-reported compliance tendency among participants despite their informal status.

In terms of measurement quality, all constructs demonstrated excellent internal consistency and convergent validity. The outer loadings for each indicator exceeded the recommended threshold of 0.70, confirming strong individual reliability [18]. Cronbach’s alpha values ranged from 0.848 to 0.897, and Composite Reliability (CR) values ranged from 0.887 to 0.922, all well above the minimum cutoff of 0.70, thereby indicating good internal consistency reliability. The Average Variance Extracted (AVE) for all constructs also surpassed the 0.50 criterion, suggesting adequate convergent validity [18].

These results provide a solid foundation for proceeding with the structural model assessment. The quality of the measurement model supports the robustness of further hypothesis testing using Partial Least Squares Structural Equation Modeling (PLS-SEM). Moreover, the findings are consistent with previous studies which affirm the importance of institutional trust and perceived justice in enhancing tax compliance behavior among informal taxpayers [1, 4, 5].

Table 3. Path Coefficients and Significance Values of the Structural Model

Path	Original Sample (β)	Std. Dev.	t-stat.	p-values	Decision
FAIR → COMP	0.342	0.058	5.897	0.000***	H1 is accepted
TRUST → COMP	0.381	0.064	5.953	0.000***	H2 is accepted
TRANS → COMP	0.276	0.053	5.208	0.000***	H3 is accepted

Note: $t > 1.96$.*** $p < 0.001$; ** $p < 0.05$.

Source: SmartPLS 4 output, authors’ calculations (2025).

The structural model assessment presented in Table 3 shows that all hypothesized relationships between the independent constructs and the dependent construct, voluntary local tax compliance (COMP), are statistically significant. The path

coefficient from perceived fairness (FAIR) to tax compliance is 0.342, with a standard deviation of 0.058 and a *t*-statistic of 5.897, indicating strong and reliable influence. This value reflects the extent to which perceptions of justice within the tax system are associated with increased compliance among informal taxpayers.

Similarly, the relationship between trust in government (TRUST) and tax compliance also demonstrates significance, with a path coefficient of 0.381, standard deviation of 0.064, and a *t*-statistic of 5.953. This suggests that higher levels of trust toward government institutions and tax authorities correspond with stronger taxpayer willingness to comply voluntarily.

Finally, fiscal transparency (TRANS) also exhibits a meaningful effect, with a path coefficient of 0.276, a standard deviation of 0.053, and a *t*-statistic of 5.208. This indicates that when respondents perceive the local government as transparent in communicating how tax revenues are used, their tendency to comply with tax obligations improves accordingly.

All *p*-values for the tested paths are below the 0.001 threshold, confirming that the model's predictive relationships are statistically robust and free from random error at a 99.9% confidence level. These results collectively support the reliability of the proposed structural model and provide a strong basis for subsequent evaluation in the next chapter.

5 Discussion

This study aimed to investigate the behavioural determinants of voluntary local tax compliance among informal sector taxpayers in Indonesia, with a specific focus on perceived fairness, trust in government, and fiscal transparency. The results confirm that each of these constructs exerts a statistically significant and positive influence on tax compliance intentions among individuals operating within the informal economy. These findings resonate with and extend prior literature, particularly within the Indonesian context, where the informal sector plays a critical yet often under-regulated role in local fiscal structures.

Firstly, the significant path coefficient between perceived fairness and voluntary tax compliance underscores the importance of distributive and procedural justice in tax systems. Respondents who perceived the local taxation system as equitable and just were more inclined to comply voluntarily. This is in line with previous studies suggesting that fairness enhances compliance by reinforcing the legitimacy of tax institutions [10, 5]. The informal sector, often excluded from formal dialogue and lacking bargaining power, is particularly sensitive to perceptions of inequity. Thus, policies that communicate fairness and apply taxation rules consistently may be especially effective for this demographic.

Secondly, trust in government emerged as the strongest predictor of voluntary compliance. This finding confirms the existing empirical consensus that institutional trust functions as a psychological substitute for enforcement among informal actors [3, 4]. Informal taxpayers are more willing to comply when they believe that tax revenues are utilised responsibly and that public officials act with integrity. This has policy

implications for local governments, suggesting that efforts to improve service delivery, reduce corruption, and foster citizen engagement can yield significant improvements in tax compliance rates.

Lastly, fiscal transparency was also found to significantly influence tax compliance, albeit to a slightly lesser degree than trust or fairness. The availability and clarity of information on how tax funds are collected and used appeared to strengthen respondents' willingness to fulfil their obligations. This supports the assertion made by Dularif and Rustiarini [8] that transparency reduces information asymmetry and builds credibility in tax authorities. For informal sector taxpayers, who may lack routine interactions with local government institutions, accessible and comprehensible fiscal information plays a pivotal role in shaping their compliance behaviour.

Collectively, the findings of this study not only reinforce prior research but also highlight the interconnected nature of behavioural, perceptual, and institutional determinants of tax compliance. Importantly, this study provides robust empirical evidence using PLS-SEM methodology and a reasonably large sample, thereby addressing methodological gaps in previous studies that relied on smaller or less representative samples. Moreover, it emphasises the need for local governments to consider non-coercive, behavioural approaches in strengthening tax collection efforts, especially from the informal sector, where formal enforcement mechanisms may be limited or ineffective.

6 Conclusion

This study examined determinants of voluntary local tax compliance among informal-sector taxpayers in Indonesia, focusing on perceived fairness, trust in government, and fiscal transparency. Grounded in behavioural public finance and analysed using PLS-SEM on 300 respondents from urban and semi-urban areas of Java (e.g., Bandung and Yogyakarta), the results show that all three factors significantly raise intentions to comply, with trust emerging as the strongest predictor. Fairness reinforces distributive and procedural justice; transparency improves access to reliable information and reduces ambiguity; and trust mediates the effects of fairness and transparency, highlighting the centrality of institutional credibility where enforcement is limited. Theoretically, the study extends the slippery-slope framework by positioning fiscal transparency as an enabling condition that, via institutional trust, links governance quality to taxpayer behaviour—underscoring the need to integrate psychological and relational mechanisms beyond deterrence in informal economies.

Practically, local governments should apply rules consistently, deliver transparent services, and invest in responsive governance and public engagement. Open budget portals, expenditure tracking, and community feedback forums can demonstrate the use of revenues, while targeted communication to informal workers through digital and grassroots channels can strengthen civic responsibility. Limitations include the geographic focus and a restricted set of variables; future research should test the model across provinces with differing institutional performance, incorporate additional constructs (e.g., religiosity, perceived corruption, moral obligation, digital inclusion),

and adopt longitudinal designs. Overall, enhancing voluntary compliance requires a people-centred approach that advances fairness, transparency, and trust to build an inclusive and sustainable local fiscal system.

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