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The Impact of Tax Fairness on Sales Tax Evasion: Mediating Roles of Trust in Tax Authorities and Perceived Tax Deterrence among Pakistani SMEs

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ABSTRACT

Sales-tax evasion remains a persistent challenge in developing economies, especially among small and medium-sized enterprises (SMEs) where formal monitoring is limited, and informal norms are strong. In Pakistan, where SMEs form the backbone of the economy, evasion not only erodes public revenue but also fosters unfair market practices. While enforcement and institutional trust are often studied, the social dynamics, particularly peer influence, have received limited scholarly attention in this context. This study investigates how peer influence affects sales-tax evasion behavior among SMEs and whether this relationship is mediated by trust in tax authorities and perceived deterrence. By extending the slippery slope framework, the research aims to reveal the psychological and social mechanisms through which compliance decisions are shaped. The objective is to inform contextually appropriate policy responses that address both attitudinal and behavioral drivers of tax evasion. A structured survey was distributed to get a response and 367 respondents were used to analyze the data. Constructs including peer influence, institutional trust, perceived deterrence, and evasion behavior were measured using validated scales. Structural equation modeling (SEM) was employed to assess direct and mediated relationships. Reliability and validity were established through confirmatory factor analysis, while procedural controls helped minimize common method bias. Results confirm that peer influence significantly increases the tax evasion. However, this effect weakens when trust in tax authorities is high, demonstrating the mediating role of institutional legitimacy. Perceived deterrence negatively mediated the relationship, suggesting that stronger enforcement perceptions can suppress the contagion effect of peer behavior. Trust and deterrence explain a substantial portion of the indirect effects. These findings suggest that enhancing taxpayer trust and making enforcement more visible can jointly reduce peer-driven evasion. The study contributes to the behavioral tax literature and offers practical insights for regulatory bodies in emerging markets.

Keywords: *Tax Fairness, Sales Tax Evasion, Trust in Tax Authorities and Perceived Tax Deterrence*

INTRODUCTION

Debates around tax evasion have garnered intense attention as revenue leakage continues to burden governments worldwide. While traditional economic models depict tax evasion as a rational calculation weighed by audit probabilities and fines (Chan et al., 2023)., recent scholarship emphasizes socio-psychological dimensions of taxpayer behavior. Peer influence, trust in tax authorities, and perceived deterrence have emerged as crucial predictors of noncompliance (Al-Rahamneh & Bidin, 2022; Okpeyo et al., 2024). Al-Rahamneh and Bidin's (2022) study among Jordanian SMEs found that peer influence significantly increased sales tax evasion, whereas trust and fairness negatively impacted it. This suggests that beyond financial calculus, social norms and institutional legitimacy shape compliance decisions.

Evidence indicates that taxpayer behavior is molded by more than enforcement mechanisms. Peer behavior carries a powerful signal: observing evasion within one's network greatly increases individual noncompliance (Mugambi et al., 2024). Similarly, diminished trust in tax authorities erodes voluntary compliance, while perceived deterrence, through audits and penalties, can mitigate evasion but is often insufficient when social trust falters (Gao et al., 2021). Slippery-slope framework studies demonstrate an interactive effect: fairness and trust enhance compliance, especially when paired with credible enforcement (Muehlbacher et al., 2011; Torgler & Murphy, 2004). These patterns have been documented in both developing and developed nations, illustrating a consistent global trend (Chan et al., 2023).

At the global level, the Organization for Economic Co-operation and Development (OECD) estimates that tax evasion costs governments up to 20% of potential revenue annually (degl'Innocenti et al., 2022). This shortfall undermines public service provision, economic stability, and trust in governance. In Jordan, SMEs contribute over 40% of employment, yet face persistent sales tax evasion, resulting in JOD 774 million in lost revenue in 2019 alone, about 17% of sales-tax receipts (Mugambi et al., 2024). Pakistan confronts similar challenges: low compliance rates among SMEs in Punjab have strained provincial budgets and hindered social welfare expansion. Social norms of under-declaration remain widespread, compounded by distrust in tax authorities and perceived weak deterrence (Gao et al., 2021). These overlapping concerns underscore the need to understand underlying socio-psychological drivers across scales, from global revenue loss to local compliance behavior.

Despite growing acknowledgment of behavioral factors, critical gaps remain in understanding how peer influence, institutional trust, and deterrence interplay in shaping tax evasion, especially in developing contexts with weak governance. While Mansour et al. (2023) study highlighted peer influence as a key determinant, it did not simultaneously analyze the mediating roles of trust and deterrence. Most empirical work has focused on income tax, neglecting sales tax, which is more salient for SMEs and local markets. Equally, much research uses cross-sectional surveys, leaving dynamic interactions between variables underexplored. For Pakistan, there is almost no empirical evidence linking these socio-psychological constructs to sales tax behavior at the SME level (Chan et al., 2023). This represents a significant blind spot, given the large informal economy and reliance on indirect taxation in provinces like Punjab. My research responds to this gap by investigating the combined and conditional effects of peer influence, trust in tax authorities, and perceived deterrence on sales tax evasion among SMEs. By modeling interactions and potential mediation, i.e., whether trust or deterrence buffers peer effects, this study advances beyond simple linear assumptions.

Addressing this problem is vital for multiple reasons. Sales tax revenue forms a cornerstone of local government finance, funding essential services such as education, healthcare, and infrastructure. Persistent evasion undermines these services and erodes public trust. SMEs, often the backbone of regional economies, may gain unfair advantages, distort local markets and perpetuate informal sector growth (Gao et al., 2021). If peer-influenced evasion becomes normative, policy efforts focused solely on enforcement may fail or even backfire by reinforcing social norms against compliance. Finally, understanding the roles of trust and deterrence is crucial for designing balanced policy responses, such as enhancing administrative transparency or targeted penalties. Given Pakistan's experience with limited audit capacity, leveraging social dynamics may offer cost-effective compliance strategies. Thus, elucidating these socio-psychological drivers not only contributes academically but also holds practical significance for tax policy and economic development.

This study adds value by integrating socio- psychological variables in a context-specific model of sales tax evasion among SMEs in a developing region. It advances theoretical understanding by examining not only direct effects but also mediating among peer influence, trust, and deterrence (Chan et al., 2023). Empirically, it provides novel data on Pakistani SMEs, filling a critical geographic and tax-type gap. The findings will guide more nuanced, culturally attuned compliance policies, offering insights for policymakers seeking to curb evasion without overreliance on audits.

By unpacking how peer norms, institutional trust, and deterrence interact, this research informs tax authorities seeking cost-effective compliance strategies, especially in resource-constraint settings. (Mansour et al., 2023) Theoretically, it extends behavioral tax models to sales tax and SME contexts in developing economies. Practically, it offers targeted interventions, peer- based messaging and trust-building initiatives may enhance voluntary compliance more than harsh penalties. Finally, it engages the slippery- slope framework (Kirchler et al., 2008) as a unifying theory, demonstrating how trust and enforcement jointly shape behavior. This theoretical application enriches the discipline and improves the model's explanatory power across contexts.

Theoretical Framework

The slippery slope framework (SSF), introduced by Kirchler, Hoelzl, and Wahl (2008), offers a comprehensive perspective on tax compliance by integrating both economic deterrence and psychological factors. As opposed to classical models (e.g., the role of audits, penalty) SSF suggests that compliance occurs through two independent yet interrelated pathways power of authorities (i.e., deterrence) and trust in authorities (i.e., voluntary cooperation). The power component means the perceived ability of tax authorities to identify and punish evasion whereas trust includes the faith that the authorities are just, transparent and in the interest of all (Kogler et al., 2013). Taxpayers do so in fear to the tax. This is enforced compliance that is followed when the taxpayers have a perception that the tax collection is associated with great power of enforcement (Chindengwike, 2024). Where they have confidence in the tax institutions, they will be motivated to comply with taxes willingly and out of internal necessity. SSF consequently incorporates a coercive and a collaborative aspect of compliance and alludes that sustainable tax behavior can be achieved when using power and trust in equal measure.

Recent studies have validated SSF across diverse contexts, including developing economies where institutional quality and informal norms vary widely (Muehlbacher et al., 2022). According to empirical findings, trust is more effective than deterrence in facilitating the long-term compliance than in industries where social cohesion is prevalent, including in the small and medium enterprises (SMEs) (Chindengwike, 2024). Authorities are viewed as corrupt, unfair, and inconsistent; compliance reduces to making deterrence the most influential force (Gebrihet et al., 2024). The other problem is that excess enforcement can be counterproductive in promoting confrontational relations and resistance among taxpayers. Conversely, voluntary compliance can be encouraged by ensuring regular practices, educating taxpayers, and service-based models, which incur fewer costs on over-enforcement than the institutional trust (Mansour et al., 2023). SSF framework is also capable of accommodating the presence of peer influence since social norms may enhance or diminish trust as well as the perceived authority. In such a way, the use of SSF in empirical studies, and, primarily, in quantitative ones offers a solid theoretical framework to investigate a complex behavioral interplay underpinning tax evasion. The SSF is a very important filter that must be used to develop a balanced, effective, and relevant tax policy based on local contexts when the government is low on the scale of both trust and enforcement capacity within the context of a developing nation such as Pakistan.

Hypothesis Development

Tax compliance behavior is not formed in isolation; it is deeply embedded within the social networks and cultural norms that shape individual decision-making. Rational choice Model states that a situation where an individual avoids tax is only possible where the costs of evasion are less than the perceived benefits (Allingham and Sandmo, 1972; Chindengwike, 2024). This view is biased as it disregards the important influence of the social dynamics on behavior. Researchers also lay more and more stress on the role of social influence, people preferentially imitate activity and attitude of their peers (Mansour et al., 2023). Where tax evasion is accepted as the norm in a group of peer individuals, particularly in the context of a small business or tightly knit community, there may exist a sense among individuals where the tax law is accepted as optional or even to be anticipated. Peer networks are more influential in decision making regarding taxes, as they are a major source of information, recommendations and behavioral guidance of SMEs (Hofmann et al., 2014). This indicates that witnessing that peers avoid taxation without any penalties can lower the moral or perceived incident of punishment that involves noncompliance of taxation.

The strength of peer influence is often amplified in environments where institutional trust is weak, and enforcement mechanisms are perceived as ineffective. Taxpayers can be more influenced by social norms than regulation, especially when their neighbors and acquaintances commit the same type of violation (Gebrihet et al., 2024). This kind of social contagion effect tends to be great in the informal economy and semi urban markets where peer behavior will be more visible and the ability to enforce is less. Al-Rahamneh and Bidin (2022) research on SMEs in Jordan concluded that the direct and significant effects of peer impact on the sales tax evasion indicates the notion prevailing in the context that taxpayers are not appealed by deterrence only, but also by the example they see as undertaken by others. Routine justification of evasion among a group of peers may reduce internal restraint to transgression, as a person has more of an incentive to justify immoral behaviors (Gao et al., 2021). The research of the influence of peer power on the establishment of the behavior of tax evasion needs to be examined cautiously concerning the social norm and the whole institutional setting. It would be safe to anticipate based on this set of literatures that peer networks contribute greatly to the likelihood of an SME involving in sales tax evasion.

H1: Peer influence has significant positive effect on Sale tax evasion.

The influence of social norms on taxpayer behavior is increasingly acknowledged in the behavioral tax compliance literature. People tend to borrow behavior clues in situations where taxation laws are complicated or when they consider noncompliance tolerated (Al-Rahamneh & Bidin, 2022). When the tax evasion is put in its default state within a group of peers, people can use the sense of common behavior to excuse their lack of compliance. But how far such peer norms are put into practice evasion there might be a lot of influence of the rapport of the taxpayer with the institutional authorities. Particularly, the effect of social pressures can be changeable depending on the perceptions of fairness, transparency, and integrity of tax institutions. Taxpayers immersed in a system that promotes non-compliance might remain willing to pledge through such tax collection, as they would feel that the tax body is highly competent to carry out its work, fair, and works towards the common good (Kirchler et al., 2008). When the level of trust toward tax authorities is low, the impact of peer pressures will be more significant, agencies against noncompliance. Hence, not only the interpretation but also the reaction of taxpayers to peer behaviors is not completely determined by social norms; it is also dependent on their institutional trust (Romaniuc et al., 2022).

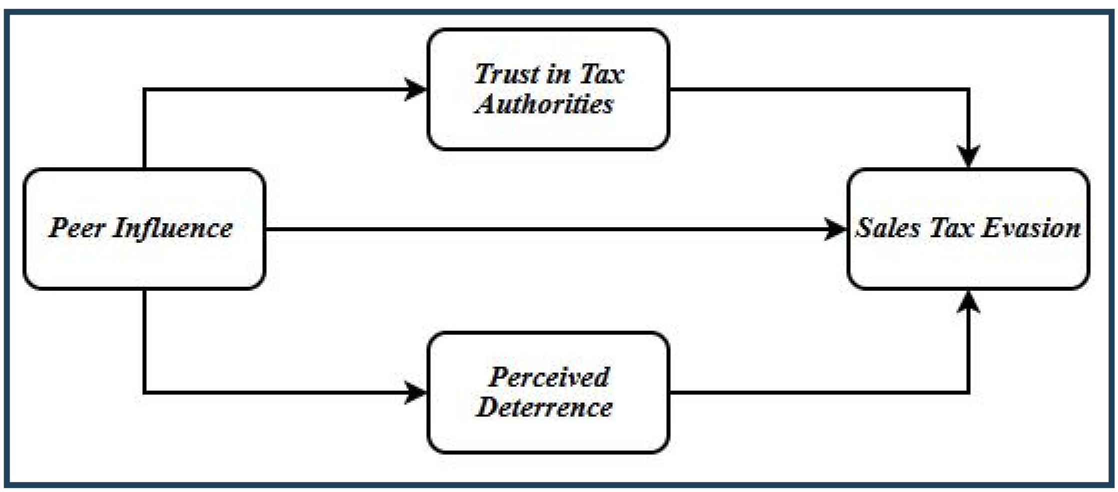
The slippery slope framework supports this interaction by proposing that trust in tax authorities fosters voluntary compliance, whereas the absence of trust pushes individuals toward evasion unless strong enforcement mechanisms are present (Kirchler et al., 2008; Kogler et al., 2013). Trust is connected as both cognitive and emotional filter on how the taxpayers perceive their social environment and the behaviors of their peers. High levels of trust in tax authorities may make evasion look less acceptable or morally problematic even in cases where a person is being practically surrounded by peers who take such measures. Such postulations do not only trust as a direct antecedent to compliance but also as a possible mediating mechanism that expounds how and when peer influence can be translated into behavior. This direction is corroborated by empirical evidence: Gebrihet et al. (2024) have shown that, in fragile states, where peer pressure is particularly strong, institutional trust is sufficient to lead its citizens towards tax compliance. Thus, confidence in tax authorities can be vital as a psychological mechanism that directs the influence of social norms towards a compliant or tax evasion path (Romaniuc et al., 2022). With the amount of peer influence and the level of institutional credibility that differ in settings such as Pakistan, it is essential to study this mediating role in order to provide more insights on the environmental influence on determining and reducing sales tax evasion among SMEs. Persons will tend to be influenced into tax evasion when they have developed an environment of people around them who allow conduct of business. When they trust tax authorities, their trust may foresee the impact of peers and have low chances of eluding (Kirchler et al., 2008; Gebrihet et al., 2024). So, trust is an intervening process, able to either enhance the negative peer-influencing impact on doubtful behavior or diminish it.

H2: Trust in Tax Authorities mediates between Peer Influence and Sales Tax Evasion

Social norms are powerful behavioral drivers, particularly in settings where formal institutions struggle to enforce compliance. When evasion practices become normalized within peer networks, they often override regulatory frameworks, especially in informal economies and SME sectors (Al-Rahamneh & Bidin, 2022). Individuals observing widespread noncompliance among their peers may perceive tax evasion as low risk or even socially acceptable. However, how individuals interpret and act on these social cues may depend on their perceptions of enforcement strength, namely, whether they believe authorities are capable and likely to detect and penalize noncompliant behavior. While peer influence encourages conformity to group behavior, the cognitive calculation of legal risk may mediate the extent to which individuals succumb to that pressure (Kirchler et al., 2008). If taxpayers believe that audits are rare or penalties are minimal, peer-induced evasion becomes more attractive. Conversely, when perceived deterrence is high, even individuals embedded in noncompliant peer networks may suppress such tendencies out of fear of consequences (Romaniuc et al., 2022). Thus, compliance decisions in socially influenced environments are not made in a vacuum, they are filtered through individual perceptions of regulatory risk.

The deterrence theory in tax compliance research argues that the perceived probability of detection and severity of penalties are core mechanisms for discouraging evasion (Allingham & Sandmo, 1972). Yet, deterrence is not only an external factor, it can be made personal in different social conditions. Where individuals get the impression that peers avoid taxes with impunity, perceived deterrence can weaken them, further propagating in the collective the idea that the power of the government is weak (Muehlbacher et al., 2022). Conversely, when people feel that the taxation agency is becoming more watchful, they might become less like their colleagues so as to keep out of the sanctions. This brings in an important path by which deterrence may operate, by mediating the association between social norms and behavior. Recent findings indicate that deterrence perceptions can be changed and altered depending on whether one has been exposed to an experience of peers who have either been confronted by enforcement or evaded enforcement (Gebrihet et al., 2024). Thereby, peer influence affects behavioral intention directly and the perception of enforcement risks made by individuals, through which the decision to comply is derived. Developing economies, such as in Pakistan, where the capacity to enforce is always doubted, but peer networks are strong, it is important to know more about this indirect pathway, in order to devise a realistic and effective strategy to convince SMEs to comply with taxation. When people are influenced by other people who do not pay up their taxes, there are high chances that they will want to commit the same vice. When they experience high deterrence, however they feel like there is a high chance of being audited or harsh slap on the wrist, they are less prone to be influenced by peer pressure (Romaniuc et al., 2022; Muehlbacher et al., 2022). Perceived deterrence negatively mediates the effects of peer influence to evasion. It weakens the link by increasing fear of consequences, discouraging evasion despite peer behavior.

H3: Perceived Deterrence mediates the relationship between Peer Influence and Sales Tax Evasion



METHODOLOGY

This study employs a quantitative, cross-sectional research design, which is suitable for analyzing hypothesized relationships among variables at a single point in time. This approach allows for efficient collection and analysis of numerical data to test the influence of behavioral constructs on sales tax evasion (Creswell & Creswell, 2018). The research is rooted in a positivist paradigm, prioritizing empirical evidence and generalizability through structured instruments and statistical modeling (Hair et al., 2022).

The target population consists of registered small and medium-sized enterprise (SME) owners or finance, account managers operating in the retail and service sectors in Punjab, Pakistan. These firms are registered under the Punjab Revenue Authority (PRA) and are obligated to collect and remit sales tax on services or sales tax on goods (if also registered with FBR). SMEs are selected because they are the most affected by peer behavior and institutional weaknesses, and often show high variability in compliance (Al-Rahamneh & Bidin, 2022). The focus on owners and finance/account managers ensures that participants are directly responsible for tax-related decisions, thus providing informed and reliable responses.

Given the lack of a centralized and publicly available database of SMEs at the city level, the study adopts a non-probability purposive sampling technique. This approach is appropriate when specific knowledge or characteristics are required of respondents, and where the sampling frame is not fully accessible (Etikan & Bala, 2017). Eligibility criteria include businesses registered with PRA or FBR, and operating for at least two years. To determine the appropriate sample size, guidelines for PLS-SEM were followed. Hair et al. (2021) suggest that for models with multiple constructs and paths, a sample of at least 300-400 respondents are adequate to ensure statistical power and model stability. Accordingly, this study targets a sample size of 400 respondents and consequently 367 responses got to analyze the data, which supports both measurement and structural model testing. Data will be collected using a structured questionnaire, comprising measurement items adapted from validated prior studies. The data will be analyzed using SmartPLS 4.0, which is well-suited for analyzing complex models and is robust against non-normal data distribution (Ringle et al., 2022). The methodology ensures rigorous, statistically sound, and contextually appropriate analysis, contributing to behavioral tax compliance theory and practice. All constructs used a 7-point Likert scale ranging from 1 (strongly disagree) to 7 (strongly agree). Peer influence has 8 items taken from previous literature developed by Alkhatib et al. (2019). Sale tax has 8 items and the items were taken from previous literature developed by Alkhatib et al. (2019). Trust in Tax Authorities has 6 items taken from previous literature developed by Alkhatib et al. (2019). Perceived Deterrence has 6 items and the items were taken from previous literature developed by Verboon. (2012).

DATA ANALYSIS

Measurement Model

The measurement model is a fundamental component of structural equation modeling that specifies how theoretical constructs are empirically captured through observable indicators. Behavioral and social sciences have lots of variables of interest (e.g. trust, deterrence or peer influence) which are latent and impossible to measure. They are implicit and are determined by using a set of connected survey questions. The measurement model offers a structure in terms of how good these observed variables measure the underlying latent constructs. Testing a structural relationship among variables is an activity that is always subjected to quantitative research conducted on some structural equation as PLS-SEM, in particular, that only when, first, there has been an existing assessment of the measurement model. This is necessary to facilitate meaningful interpretation of data since such constructs under study would be gauged with enough accuracy and uniformity (Hair et al., 2021).

Measurement model assessment involves evaluating the quality and appropriateness of the indicators used to measure each construct. This involves determining internal consistency of the items, how well the items are actually measuring the construct they are supposed to measure in and how unique the constructs are distinct to each other. When construct is neither measured reliably nor does it have adequacy of a unique dimension, any finding regarding its own influence or relationship to other measures, are in question. A strong measurement model enhances the empirical validation of the research work itself as well as the theoretical aptness of the research results. Close evaluation of the measurement model enables the researchers to identify any form of measurement errors that would otherwise skew or distort the structural relationships between constructs. Validity of the measurement model is especially important in the study of behavioral tax compliance where perceptions, attitudes and beliefs, which are subjective and sensitive, are the focus of analysis. Replicability, comparison, and generalization between multiple studies and populations would also be aided by use of a measurement model that would be validated, thus adding to the body of scientific knowledge.

Factor Loadings

Table 1: Regression Weights

		PD	PI	STE	TTA
Perceived Deterrence (PD)	PD1	0.807			
	PD2	0.805			
	PD3	0.817			
	PD4	0.865			
	PD5	0.856			
	PD6	0.796			
Peer Influence (PI)	PI1		0.895		
	PI2		0.873		
	PI3		0.854		
	PI4		0.836		
	PI5		0.873		
	PI6		0.899		
	PI7		0.832		
	PI8		0.917		
Sales Tax Evasion (STE)	STE2			0.742	
	STE3			0.748	
	STE4			0.792	
	STE5			0.845	
	STE6			0.768	
	STE7			0.814	
Trust in Tax Authorities (TTE)	TTA1				0.850
	TTA2				0.898
	TTA3				0.869
	TTA4				0.905
	TTA5				0.839
	TTA6				0.867

The outer loadings of all measurement items for the latent constructs, PD, PI, STE, and TTA, exceed the recommended threshold of 0.70, indicating strong indicator reliability (Hair et al., 2021). In case of PD, the loadings of the items are between 0.796 and 0.865, implying that the items are significant contributors of the variance in the construct. On the same note, PI items can be described to have excellent reliability in terms of loading 0.832-0.917 meaning that PI is highly represented by its indicators. The loadings of

STE items are less than 0.9, which is also acceptable in social science studies, as 0.742 to 0.845 loading is equivalent to an acceptable representation of sales tax evasion behavior (Hair et al., 2021). The TTA indicators load ranged between 0.839 and 0.905 which indicate high internal consistency and convergent validity. It ensures that the measurement model is adequate (Ringle et al., 2022) and supports the unidimensionality of each construct as well as reliable variable reliably measures the respective latent variable because the factor loadings were high in all constructs (Donohew et al., 2019). These results therefore give assurance of going ahead to test the structural relationships among constructs in the SmartPLS framework.

Reliability Statistics

Table 2: Reliability Statistics

	Cronbach's alpha	(rho_a)	(rho_c)	AVE
Perceived Deterrence (PD)	0.906	0.907	0.927	0.680
Peer Influence (PI)	0.955	0.957	0.962	0.762
Sales Tax Evasion (STE)	0.876	0.882	0.906	0.617
Trust in Tax Authorities (TTE)	0.937	0.938	0.950	0.760

The reliability and validity results for all constructs indicate a strong measurement model. The Cronbach relationships measure the degree of internal consistency, which ranges between 0.876 and 0.955 or higher than the recommended levels of 0.70 (Hair et al., 2021). Likewise, the rho_A and composite reliability (rho_C) values of all constructs are more than 0.80 thus, verifying construct reliability. In particular, both PI and TTE demonstrate outstandingly high indicators of reliability, 0.962 and 0.950, respectively. All the constructs average variance extracted (AVE) are above 0.50 indicating that there is a strong convergent validity, that is, each construct is greater than 50 percent variance in terms of the indicators (Fornell & Larcker, 1981). Such findings justify the fact that the constructs, PD, PI, STE, and TTA, are assessed correctly, reliably, and validly and they can be further analyzed in the structural model with SmartPLS.

Discriminant Validity

Table 3: HTMT

	PD	PI	STE	TTA
Perceived Deterrence (PD)				
Peer Influence (PI)	0.620			
Sales Tax Evasion (STE)	0.460	0.429		
Trust in Tax Authorities (TTE)	0.612	0.571	0.463	

The HTMT matrix confirms discriminant validity, as all inter-construct values remain well below the 0.85 threshold. This fact shows that all constructs PD, PI, STE, and TTA represent different conceptual domain. The moderate correlation coefficient of 0.620 between PD and PI indicates that it produces a significant relationship, yet there is no conceptual overlap. The values of lower correlations of 0.429 between PI and STE and 0.460 between PD and STE imply the lack of redundancy between constructs. Such differences support the theoretical framework, especially the slippery slope model, due to which there are different roles of social/institutional factors in the formation of the compliance behavior (Kirchler et al., 2008). Therefore, HTMT outcomes contribute to the validity of the measurement model, and the data demonstrated that the further structural analysis is based on an adequate empirical basis (Hair et al., 2021; Henseler et al., 2015).

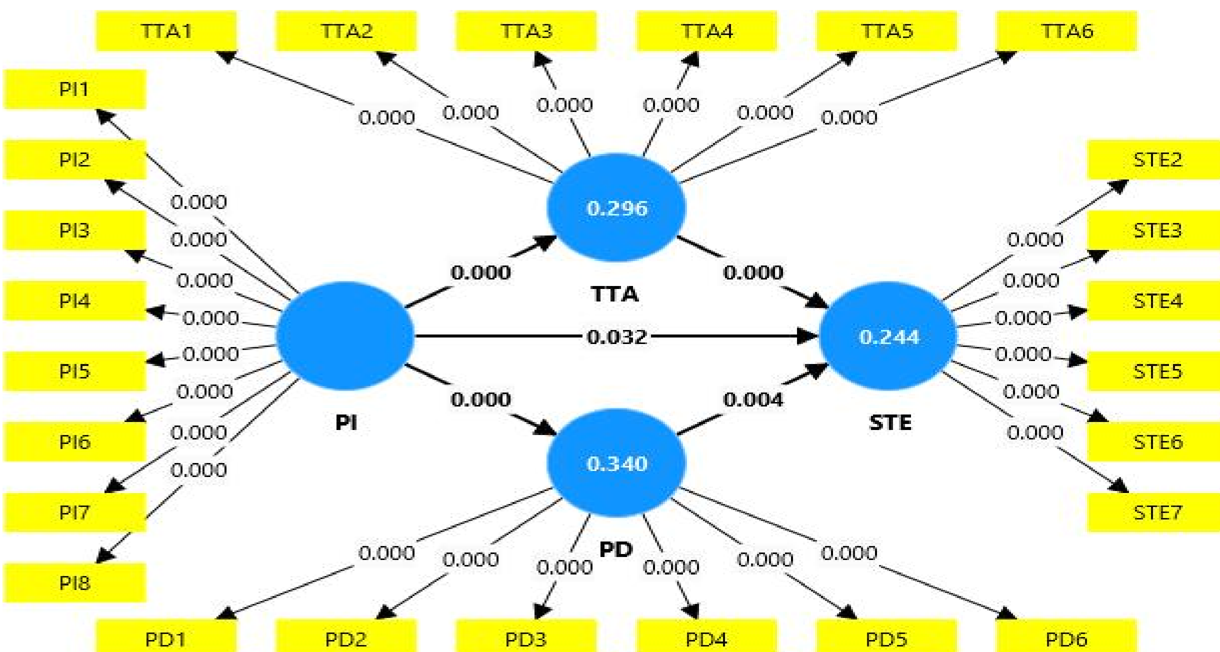
Structural Model Predictive

Table 4: R Square Value

	R-square	R-square adjusted
Perceived Deterrence (PD)	0.340	0.338
Sales Tax Evasion (STE)	0.244	0.238
Trust in Tax Authorities (TTE)	0.296	0.294

The values in the R-square values indicate the amount of variance in the independent variables in the structural model. According to STE (R^2 = 0.244), it implies that the explanatory power of PI, TTA, and PD because only about 24.4 percent of its variance is determined (Hair et al., 2021). The PI also explains PD (R^2 = 0.340) and TTA (R^2 = 0.296), which means that it plays the vital role in future perceptions and institutional trust development. The values thus show that the model is effective in capturing the most important behavioral factors of influence on the results of compliance with taxes (Hair et al., 2021).

Structural Equation Modelling (SEM)



Findings

Table 5: Results

	Original sample	Sample mean	Standard deviation	T statistics	P values
PI -> STE	0.150	0.150	0.070	2.145	0.032
PI -> TTA -> STE	0.132	0.131	0.035	3.774	0.000
PI -> PD -> STE	0.113	0.115	0.041	2.773	0.006

The structural model results reveal significant direct and indirect effects of PI on STE, both through TTA and PD. The immediate impact of PI on STE (0.150 p = 0.032) suggests that PI accelerates the possibility of tax evasion in line with the conclusion that social norms may normalize that noncompliance is acceptable among the peers (Al-Rahamneh & Bidin, 2022). But the indirect effects bring more information about the mechanisms. The mediating path (beta = 0.132, $p < 0.001$) indicates that TTA considerably mediates the effects of PI on the evasion. That implies that the risk of copying the escape of those peers can be reduced by high trust towards the institution, which is consistent with the direction of the slippery slope framework determining the voluntary compliance (Kirchler et al., 2008). The by-way relationship via PD (0.113, p 0.006) demonstrates a considerable conceptual drift in hypothesis 3. But though statistically significant the direction of this mediation is reverse to what was hypothesized i.e. in which deterrence would strengthen the effect of peer pressure on evasion. PD acts as a negative mediator in the influence of PI, which means that increasing the feeling of law enforcement dampens the inclination to cope with the peers in the evasion behavior. This implies that even when people are being exposed to evasion by peers, they might not engage in evasion of taxes when they fear to be detected or to face the consequences. H3 cannot be supported.

DISCUSSION

The findings affirm that entrepreneurs embedded in networks where evasion is common tend to mirror that behavior, underscoring the potency of social norms in shaping compliance decisions (Al- Rahamneh & Bidin, 2022). This outcome aligns with the Slippery Slope Framework's assertion that taxpayers observe and internalize the conduct of significant others before deciding whether to comply (Kirchler et al., 2008). In Pakistan's SME sector, dense informal ties magnify such contagion effects; when peers boast about under- reporting without apparent consequence, the moral and psychological costs of evasion diminish (Mugambi et al., 2024). Prior work in Jordan and sub- Saharan Africa documents similar patterns, suggesting that peer cues carry comparable weight across developing economies with weak enforcement capacity (Okpeyo et al., 2024). By confirming H1, this study adds evidence that purely deterrence- based interventions may falter unless the normative environment is simultaneously addressed, for example through peer- to- peer compliance campaigns that reframe evasion as socially unacceptable (Gao et al., 2021)

The mediation analysis indicates that trust in tax authorities tempers the transmission of peer- based evasion norms, echoing the Slippery Slope proposition that voluntary cooperation flourishes when taxpayers perceive institutions as fair and service- oriented (Kogler et al., 2013). Even in networks rife with non- compliance, SMEs who regard the Punjab Revenue Authority as transparent and responsive display lower propensities to follow suit (Chan et al., 2023). This buffering role corroborates experimental evidence from fragile states where bolstering institutional legitimacy offsets social pressures toward evasion (Gebrihet et al., 2024). It also extends Mansour et al.'s (2023) argument that trust can convert externally imposed rules into internalized obligations. Practically, the result signals that investments in taxpayer services, clear communication, and visible fairness may yield dual dividends: they not only generate direct goodwill but also weaken the social diffusion of illicit behaviour. Hence, H2 is supported, illustrating trust as a pivotal psychological filter through which peer signals are interpreted (Romaniuc et al., 2022).

Perceived deterrence did not amplify the peer–evasion link, stronger perceptions of audit probability and sanction severity reduced the likelihood that entrepreneurs would emulate evading peers, thus negating H3. This divergence highlights a nuanced interaction between social learning and risk calculation. Classical deterrence theory posits that higher perceived enforcement should universally discourage evasion (Allingham & Sandmo, 1972). Yet, in environments where peer stories circulate rapidly, individual risk assessments appear contingent on vicarious experiences: when audits are viewed as credible, social encouragement to evade loses persuasive power (Muehlbacher et al., 2022). The negative mediation related to Romaniuc et al.'s (2022) findings that deterrence can outweigh peer conformity when enforcement signals are salient.

LIMITATIONS AND FUTURE DIRECTIONS

Despite offering valuable insights into the dynamics of peer influence on sales-tax evasion among SMEs in Pakistan, this study is not without limitations. The cross-sectional design restricts the ability to infer causality. While significant associations were identified, the direction of influence, particularly in the mediated pathways, may evolve over time or reflect bidirectional processes. Future research could adopt longitudinal or experimental designs to establish temporal precedence and better isolate causative mechanisms (Kogler et al., 2013). The study focused exclusively on SMEs operating within a specific regional context (Punjab), potentially limiting the generalizability of the findings to other provinces or national contexts where enforcement regimes, institutional trust, and peer cultures may differ (Chan et al., 2023). Comparative studies across regions or developing countries with varying tax capacities would enrich our understanding of contextual contingencies. Reliance on self-reported data introduces the possibility of social desirability bias, especially when discussing illicit behaviors like tax evasion. Although anonymity was assured, future studies might integrate objective administrative data or employ indirect questioning techniques to enhance validity (Romaniuc et al., 2022). The construct of "peer influence" was operationalized through perceptual measures rather than network-based metrics. Future research could benefit from using social network analysis to map actual peer connections and quantify the density, centrality, or homogeneity of evasion norms within SME ecosystems (Muehlbacher et al., 2022). While the current model captures cognitive mediators (trust and deterrence), it does not incorporate emotional or moral dimensions, such as guilt, shame, or tax morale, which may further shape compliance decisions. Subsequent studies should explore these affective variables to offer a more holistic view of taxpayer psychology. Expanding the theoretical lens to include moral psychology or behavioral ethics could yield deeper insight into why peer cues hold such persuasive power.

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