

# FACTORS INFLUENCING TAX EVASION IN THE DEVELOPING COUNTRY: A REGULATORY POLICY CONTEXT

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## Abstract

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Albania is a country that emerged 30 years ago from a centralized and closed economy, where the state controlled the entire economy. During these 30 years, it has experienced a strong transition and has gone through economic and political crises, which have influenced the strengthening or weakening of the role of the state and its economy. One of the problems that remains worrying for Albania is the high level of tax evasion, a phenomenon that weakens the role of the state in the development of stimulating regulatory policies (Tanzi & Shome, 1993), as well as in maintaining financial and economic stability. Economic crime or financial fraud is always the biggest challenge to the local economy (Sutherland, 1940). Through this study, we aim to analyze the main factors influencing tax evasion in Albania, the factors that affect the ability of taxpayers to fulfil their tax obligations, as well as the factors that affect the level of tax income declared by tax-paying entities. We have used primary data taken from a questionnaire with taxpayers and from an interview with tax administration employees. Data have been analyzed through statistical methods, and conclusions were reached to make this research important to tax policymakers.

**Keywords:** Tax Evasion, Taxpayer, Fiscal Policy, Economic Crime

**Authors' individual contribution:** Conceptualization — A.G.; Methodology — A.G.; Formal Analysis — S.U.; Data Curation — G.G.; Writing — Original Draft — A.G.; Writing — Review & Editing — A.G.; Supervision — G.G.; Project Administration — A.G.

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## 1. INTRODUCTION

Tax evasion refers to the illegal phenomenon of avoiding the payment of tax obligations through non-declaration of income, overestimation of expenses, concealment of transactions, or their manipulation by taxpayers. This phenomenon is related to different factors that lead to its increase or reduction, such as the attitude of taxpayers towards tax declarations, their tax culture and knowledge, the level of punishment for tax evasion, the number of tax audits and their efficiency, the level of reliability of tax audits, the size of business, the paying ability of businesses, the professional skills of tax inspectors,

demographic factors such as age, gender and education etc. Many authors have tried to identify the many ways of realizing tax evasion, such as Sisson (1981), Richupan (1987), Cowell (1990), Webley et al. (1991). In different states, the ways of realizing tax evasion are different, just as in different sectors the possibilities of realizing tax evasion are different. For three decades in Albania, the most popular forms of tax evasion have been non-declaration of employees in the declaration of monthly salaries or partial declaration of the salaries of employees, non-declaration of tax income through non-declaration of sales invoices, overestimation of expenses through the declaration of invoices fictitious expenses. The treatment of tax evasion as

a criminal offence in Albania was included only in 1993 through Law No. 7669, dated 16.11.1993, to be included later in the Penal Code of 1995 (Penal Code of the Republic of Albania, Law No. 7895, 1995). This means that the punishment ability of this phenomenon has only started to be applied in the last two decades, and this not-long period of disciplining the phenomenon shows insufficient attention on the part of policymakers, but also of economic researchers and experts. Tax revenues are necessary for the functioning of the state, the provision of national services, and the regulation and supervision of markets, but also to ensure the social character of the state in the provision of mandatory services for the country, such as national security, education, health care system, the justice system, environmental protection, etc. The tax system has a significant impact on reducing consumption or completely avoiding the use of certain goods that have a negative impact on human health, such as tobacco or alcohol. So, as we can see, the tax system plays an important role in the life of every person. There are several negative phenomena linked together that influence the Albanian economy not to develop according to the directions suggested by the European Union (EU), of which we constantly aim to be a part. Among these phenomena can be mentioned the secret or informal economy which is favoured by tax evasion, also money laundering which has an element of distorting tax declarations to reflect an economic reality which does not exist (Gjoni et al., 2015). It is very important to analyze the main factors that influence the engagement of taxpayers in tax evasion since if these factors are determined as important, measures can be taken by policymakers to avoid the negative effects of these factors or to increase the positive effect if they have to this phenomenon (Gjoni & Muça, 2022). There are very few or almost no studies in Albania regarding the factors that determine tax evasion in Albania, for this reason, this study at this moment is very important and aims to fill a gap in studies regarding fiscal policies and their effectiveness. The main purpose of this study is to evaluate the factors that influence tax evasion in Albania by referring to the factors suggested by the reviewed literature.

The structure of the paper is as follows, Section 1 reviews the concept of tax evasion and the main purpose of the study, Section 2 reviews the relevant literature, Section 3 analyses the methodology that has been used to conduct empirical research on tax evasion in Albania, Section 4 describes all the relevant results of the study and discussions about the results and Section 5 present important conclusions of the study.

## 2. LITERATURE REVIEW

Tax evasion is closely related to economic crime because tax evasion itself is part of economic crime as it deals with an illegal avoidance of tax obligations, or illegal and intentional manipulation of tax obligations (Argentiero et al., 2015). Among the first researchers who tried to define and study economic crime, we mention Sutherland (1949), who defined white-collar crime as crimes committed by individuals with high social status, with sufficient education to understand the legal violation, and who enjoy authority and respect in the economic entity

where they operate. According to Sutherland (1940), those who commit economic crimes are aware of the crimes they commit, and they do not commit them because they have low income, but because they think they have the right skills to commit such crimes and not be caught by the inspectors or get caught legal or financial penalties. Tax evasion is as old as the existence of states, when the state and the tax obligation were born, that is when the tax crime was born, the willful non-declaration or non-payment of tax obligations arising from the economic activity of individuals or business entities. As stated by Tanzi and Shome (1993), this phenomenon belongs to the whole world, to all classes of society, and all roles in society, it is a universal phenomenon, inevitable but manageable and that can be kept under control and reduced within acceptable levels. Their research by Allingham and Sandmo (1972) describes tax evasion through the theory of a game where the taxpayer in the role of the person who buys a lottery ticket can choose to pay the tax liability or not, to declare the tax burden or not, and that the tax declaration process occurs under uncertainty conditions. The taxpayer is faced with two possibilities, either to declare the real tax liability and pay the entire liability in this way, or to partially declare the tax liability and pay less in this way, but in this case, face the risk of being detected by the of the tax inspectors, and then penalization. There have been about five decades in developed countries that have been looking for accurate indicators for the hidden economy (Sandmo, 2004). We can also determine the difference between tax evasion and tax evasion through the legality factor since tax evasion is completely defined as an illegal phenomenon, while tax evasion can also originate from the tax structure imposed by tax guidelines that originate from fiscal policies. Richupan (1987) determines some of the factors for the phenomenon of fiscal evasion. According to Richupan (1987), one of the main factors is the tax rate (TR), which, if it is higher, promotes tax evasion. Another factor is the level of tax punishment (fine) and the probability of detection of tax evasion by tax inspectors. Another important factor is the withholding scheme, the more the salaries and wages are part of a withholding scheme, the less the probability of tax evasion from taxpayers. Another important factor should be the self-enforcement tax system, a system that summarizes in one statement the taxes that the individual must pay, e.g., income tax, capital gain tax, wealth tax, etc. Other important factors are tax rules, price control, the level of education of the population, the detection abilities of tax evasion by tax inspectors, and the level of development of a country. A new factor that we can mention in relation to tax evasion is digitization. In our opinion, this factor can positively affect the reduction of tax evasion. In their recent study, Kong and Wang (2014) determine economic factors influencing tax evasion, such as income level, source of income, TR, punishment level, and tax control. According to Weigel et al. (1987), individuals with average income (middle level) tend to pay the appropriate taxes because they have a fairer attitude towards tax penalties as well have a higher tendency to comply with laws and regulations. If we refer to Wallschutzky (1984), we can take information about the source of income factor. According to Wallschutzky's study public sector employees tend

to have a more positive attitude towards tax evasion compared to employees in the private sector, which means that the former tend to declare tax obligations correctly, while the latter tend to manipulate tax declarations as they feel a distance with them great to tax control structures. Demographic factors influencing tax evasion are gender, age, and education. In their study, Verdugo and Schneider (1994) state that these factors are related to whether the employees are part of withholding tax professions or non-withholding professions. According to Verdugo and Schneider (1994), men have more chances to engage in non-withholding professions and declare and pay taxes for the second time, on the other hand, women have the tendency to engage in traditional professions such as teachers, nurses, sales employees, clerks and other professions who declare and pay taxes in advance and these last ones have less tendency to engage in tax evasion. Young-aged employees have a greater tendency to engage in tax evasion compared to ages over 40 years old. Younger people have a larger tendency to face risks. Another important factor influencing tax evasion is tax fairness (Alkhatib et al., 2019), procedures, tax rules, and tax burden must be fair so that individuals or tax subjects have a positive tendency towards the declaration and payment of tax obligations. Tax knowledge also influences the ability of taxpayers to engage in tax evasion, individuals having good knowledge of taxes tend not to engage in tax evasion because they have a better knowledge of punishment level and tax control (Poudel, 2018). Kassa (2021) states that subjective norms have a positive influence on taxpayers to engage in tax evasion. Stakeholders such as colleagues, and group categories tend to influence the taxpayer's attitude to engage in tax evasion. The author developed a conceptual framework based on five important factors influencing tax evasion such as moral obligation, tax fairness, tax knowledge, subjective norms, and attitude towards the behaviour. Results of this study show that tax fairness and tax knowledge have the biggest effect on taxpayers engaging in tax evasion, meaning that before all we have to develop a fair tax system and we have to offer appropriate information to taxpayers. Ameyaw and Dzaka's (2016) recent study generates data from Europe, USA, Africa, Asia, and other continents about shadow economy and tax evasion. As we can see by this study countries with the lowest level of tax evasion-GDP (gross domestic product) are the USA and China, and with the highest level, we can mention Russia and Brazil. According to World Economics (n.d.), Albania has a percentage of informal economy compared to the GDP level of 31.9%. Albania ranks 71st in the world ranking of countries with the highest level of informal economy in the world. Reducing tax evasion could be a strong stimulation for improving this ranking in the future. Another researcher has studied the relationship between corruption level and the permissibility of tax evasion in the USA, and this study states that corruption level is positively affected by tax evasion allowance (Al-Hadi & Al-Abri, 2022). In another recent study, the connection between technological changes and information and tax evasion was studied. According to this study, with the increase in technological developments, the efforts and techniques of governments to reduce tax evasion increase (Alm, 2021). Another contemporary study

studies the link between increased digitization and tax evasion. According to this study, with the increase in digitalization, the efforts of governments to find techniques to capture tax evasion and minimize it increased (Uyar et al., 2021). Researchers also argue that education is related to the ability to fight tax evasion through digitization (Uyar et al., 2024). In another contemporary study, the authors verify the relationship between the effectiveness of the government's actions to reduce tax evasion and the increased positive attitude towards ethical behaviour and control (Bani-Mustafa et al., 2024). Another contemporary study analyzes the effect of government reforms to create a sustainable environment for doing business with the aim of increasing the confidence of businesses, and therefore having an impact on reducing tax evasion and increasing the payment of tax obligations (Bakhodirovich, 2024).

The hypotheses developed in relation to this model are as follows:

*H1: There is a negative relationship between the level of the TR and the level of declaration of business income for tax effect.*

*H2: There is a positive relationship between the level of penalties from the tax audit and the level of declaration of business income for tax effects.*

*H3: There is a positive relationship between the level of skills of the control inspector and the level of declaration of business income for tax effects.*

*H4: There is a positive relationship between a business's ability to pay taxes and the level of business income declaration for tax effects.*

### 3. METHODOLOGY

In order to find the results of the study, a questionnaire addressed to taxpayers in Albania was carried out to identify the influencing factors in the percentage of declaration for tax effects and problems of fiscal policy. The independent variable taken in the study is the percentage of income declaration by taxpayers which is expressed as a percentage (of the total 100% of current income). The dependent variables taken into consideration are tax rate (*TR*) (corporate tax (*CT*) rate, personal income tax (*PIT*), value-added tax (*VAT*), social security (*SS*) and health insurance contributions (*HIC*)), number of controls (*CN*), penalties from tax control (*P*), trust in the government, size of businesses, legal status, businesses ability to pay (*AP*) and the control inspector professional skill level (*CS*). Most of the variables (except for the *CN*, size of business, and legal status) are statements expressed on a Likert scale from 1 — strongly agree to 5 — strongly disagree. The data of this study were collected through questionnaires distributed to several types of businesses in Albania, small, medium enterprises and large enterprises.

In Albania, there is a categorization for businesses depending on the number of employees and the total turnover. From the total of 300 distributed questionnaires, about 150 businesses have been cooperative and very willing to complete the questionnaire. In addition to the primary data for the realization of the study, secondary data were also obtained. Fifty interviews were conducted with employees engaged in the preparation of tax declarations.

The econometric model method and the descriptive method were used for data processing. The model of income declared for tax effects is presented as follows:

$$Y = \alpha_0 + \alpha_1 * TR + \alpha_2 * P + \alpha_3 * AP + \alpha_4 * CS + \varepsilon \quad (1)$$

where:

- Y: Declaration of income for tax effects;
- TR: Tax rate (VAT, CT, PIT, SS, and HIC);
- P: Penalties;
- AP: Business ability to pay;
- CS: Control inspector skills.

The percentage model of income declaration for tax effects is as follows:

$$Y = \alpha_0 + \alpha_1 * TR + \alpha_2 * P + \alpha_3 * CS + \alpha_4 * AP + \varepsilon \quad (2)$$

Dependent variable:

- Y: Percentage of income declaration for tax effects.

Independent variable:

- TR: Tax rate (VAT, CT, PIT, social security contributions (SSC), and HIC);
- P: Penalties from tax control;

- CS: Control inspector professional skill level;
- AP: Business ability to pay.

Other methods for finding the results of the study would involve interviews with members of the directorate of current fiscal policies in Albania, as well as the actors who participate in the consultation for tax policy changes.

#### 4. RESULTS AND DISCUSSIONS

The results of the study (based on data provided in Table 1 show that the first hypothesis is true, which means that it is true that there is a negative relationship between the level of the TR and the level of income declaration for tax effect. This means that if the TR increases, then the taxpayers' response to this change leads to their involvement in tax evasion. This factor remains important in its impact on tax evasion, as suggested by the theory discussed in the literature review. Also, the results of the study show that the second hypothesis is true, which means that there is a positive relationship between the level of fines from the tax audit and the level of declaration of business income for tax effects. So, this means that the measure of tax penalty affects the non-engagement of taxpayers in tax evasion.

Table 1. Results of the econometric model

Dependent variable: Y		Sample: 150		
Method: Least squares		Included observations: 50		
Variable	Coefficient	Std. error	t-statistic	Prob.
C	64.06505	37.27546	1.718692	0.0934
Turnover	0.300246	10.24108	0.029318	0.9768
VAT	-0.243885	4.093773	-0.059575	0.9528
CT	-2.004418	4.493028	-0.446117	0.6579
PIT	-5.492738	3.460212	-1.587399	0.1203
SS	-3.722714	5.838466	-0.637619	0.5274
HIC	4.284411	5.592837	0.766053	0.4481
CS	-0.527327	4.444619	-0.118644	0.9062
AP	-0.297415	5.475110	-0.054321	0.9569
P	6.510958	4.648035	1.400798	0.1690
R <sup>2</sup>	0.540865	Mean dependent var.		67.20000
Adjusted R <sup>2</sup>	-0.089190	S.D. dependent var.		27.63021
S.E. of regression	28.83607	Akaike info criterion		9.737988
Sum squared resid.	33260.76	Schwarz criterion		10.12039
Log-likelihood	-233.4497	Hannan-Quinn criteria		9.883610
F-statistic	0.554172	Durbin-Watson stat.		1.640607
Prob (F-statistic)	0.000000			

The regression equation is as follows:

$$\begin{aligned} \text{Percentage of income declaration for tax effects} \\ = 64.06 + 0.3 * \text{Turnover} - \\ 0.24 * \text{VAT} - 2.004 * \text{CT} - 5.49 * \text{PIT} - 3.72 * \text{SS} + \\ 4.28 * \text{HIC} - 0.52 * \text{CS} - 0.29 * \text{AP} + 6.51 * \text{P} \end{aligned} \quad (3)$$

To ensure the strength and significance of the econometric model, some important tests were conducted. The Breusch-Godfrey method was used to detect high-order serial correlation or the Lagrange multiplier (LM) test for high-order autocorrelation.

Since the value of p (0.4765) > 0.05, then the basic hypothesis on the absence of autocorrelation is not rejected (Table 2).

Table 2. Breusch-Godfrey serial correlation LM test

Breusch-Godfrey serial correlation LM test			
F-statistic	0.580617	Prob. F (2,38)	0.5644
Obs*R <sup>2</sup>	1.482632	Prob. Chi-square (2)	0.4765

The Regression Equation Specification Error Test (RESET) was also used to verify if there is a correlation between the error term and any regressor X. This correlation may occur due to measurement error of the X variable, simultaneity, presence in the model of dynamic lag terms, autocorrelation in the error term, etc. The RESET test says that the linear model is a well-specified model.

Table 3. The RESET test data

Omitted variables: Squares of fitted values			
	Value	Df	Probability
t-statistic	0.242312	39	0.8098
F-statistic	0.058715	(1, 39)	0.8098
Likelihood ratio	0.075219	1	0.7839

Since the value of p (0.7839) > 0.05, then the linear model is a well-specified model. All important tests were carried out, the stability test of businesses, where the value of p (0.5) > 0.05, then the linear model is a well-specified model. Also, the autocorrelation test was performed, the value of

$p(0.6376) > 0.05$ , then the basic hypothesis on the absence of autocorrelation is not rejected. Results show that hypothesis  $H3$  is also verified, which means that there is a positive relationship between the skills of the inspector and the level of declaration of business income for tax purposes. If the ability of the inspectors to execute effective tax controls, at the right time and with the right frequency, this is reflected in a lower engagement of taxpayers in tax evasion. The results of the study model showed that hypothesis  $H4$  is also true, which means that there is a positive relationship between the solvency of the business and the level of declaration of business income for tax effects. So, if the business is in a better financial situation, and has better-paying ability, the business is less inclined to engage in tax evasion. Results show that if turnover increases, the percentage of declaration for tax effects increases, therefore the concealment of income decreases. So, if turnover increases by one degree in assessment, the dependent variable increases by 0.3 percentage points. If the assessment that the  $VAT TR$  is high increases, the percentage of declaration for tax effect decreases and therefore the concealment of income increases. If the estimate for the  $VAT TR$  increases by one rate, the percentage of declaration for tax effect decreases by 0.01 percentage point. If the estimate that the  $CT$  rate is considered high increases, the percentage of declaration for tax effects decreases and the concealment of income increases. If the estimate for the  $CT$  rate increases by one degree, the percentage of declaration for tax effects decreases by 2.004 percentage points. If the assessment that the  $PIT$  rate is high increases, the percentage of declaration for tax effects decreases, and the concealment of income increases. If the estimate for the  $PIT$  rate increases by one degree, the percentage of declaration for tax effects decreases by 5.49 percentage points. If the estimate that the  $SSC$  rate is considered unreasonable (i.e., it is high) increases, the percentage of declaration for tax effect will decrease, and the concealment of income increases. If the assessment for  $SS$  increases by one degree, the tax effect declaration percentage decreases by 3.72 percentage points. If the estimate that the  $HIC$  rate is considered reasonable increases, the percentage of declaration for tax effect will increase and the concealment of income decreases. If the assessment for  $HIC$  increases by one degree, the percentage declared for tax effects increases by 4.28 percentage points. If the rating for the inspector's professional skills is considered to be insufficient, the rate of declaration for tax effect will decrease and the concealment of income will increase. If the rating for the inspector's professional skills increases by one degree, the percentage of declaration for tax effects decreases by 0.52 percentage points. If the business assessment considers that the business is unable to pay its tax obligations on time, the percentage of declaration for tax effects decreases and the concealment of income increases. If the business assessment rating increases by one degree, the percentage reporting tax effects decreases by 0.29 percentage points. If the assessment that the level of penalties imposed by the tax audit is high increases, the percentage of declaration for tax effect increases and the concealment of income

decreases. If the estimate for the level of penalties increases by one degree, the percentage of declaration for tax effects increases by 6.51 percentage points. The coefficient of determination ( $R^2$ ) shows that 54% of the variation in the percentage of income declaration for tax effects is explained by the factors selected as important. The rest is explained by other factors that were not considered in the study. Each of the independent variables' probabilities is greater than 0.05 (significance level), and these variables are significant. In addition to testing each variable, we also tested the overall significance of the multiple regression using the F-test. The probability of the F-statistic is 0.000000 very small so the possibility of accepting the alternative hypothesis is negligible. In conclusion, we can say that the model is important. This tax is currently considered the most complex among types of taxes to understand and apply as it refers to several segmentations of income from employment which are taxed at different rates, respectively 0,13% and 23%, and at several levels. Advance payment of income tax burdens the financial condition of the business on a moderate level. The professional skills of the control inspector are moderately sufficient and the tax control strategy is moderately risk-based. From the collected opinions, it is noted that the interviewees agree that the penalties imposed by the tax authorities are high. Businesses are on a moderate level and able to pay their tax obligations on time.

However, businesses with limited liability have a harder time paying their obligations on time. In general, there is an opinion that the fiscal policy being followed in Albania is partially right. Current fiscal policy disfavors fiscal evasion on a moderate level. The current fiscal policy creates moderate opportunities to avoid tax obligations. The current fiscal policy partially creates opportunities to hide income and expenses. Fiscal policy creates opportunities for full declaration of income and expenses for fiscal declaration purposes. Responders testify that the average percentage of income declared for tax purposes is 65%, meaning that income that is not declared for tax calculation is almost 35%, approximately at the level declared by the Institute of Statistics (INSTAT).

## 5. CONCLUSION

Tax evasion in Albania remains high, this is shown by the latest data regarding the informal economy or the hidden economy, of 31.9% of GDP, based on World Economics data for 2023 (World Economics, n.d.). Our study focused on finding the main factors that have an effect on tax evasion. We focused on businesses as the main taxpayers of the state and received data from small, medium and large businesses. We also conducted interviews and open questions to give the opportunity to express the widest possible opinions regarding the causes that promote tax evasion.  $TRs$  remain a very important factor in encouraging tax evasion. Some of the  $TRs$  are considered relatively high, such as the rate of  $PIT$ , and  $CT$ . Also,  $VAT$  is considered to be a tax that should be reduced in relation to services and supplies of goods that have difficulties and specifics. Also, an important factor is the level of penalties related to the detection of tax evasion,

even though the value of the penalties is judged high from the interviews. This factor should be taken into consideration along with the professional skills of tax inspectors, which means that more than the increase in penalties, effective in reducing tax evasion is considered the frequency and effectiveness of tax inspections. An important factor in the development of tax evasion was the solvency of businesses, which means that those businesses with good solvency are less likely to engage in tax evasion, and vice versa. From the data from the questionnaires and interviews, we conclude that there is still a lot of work to be done by policymakers regarding the reduction of tax evasion. Taking into account these factors that we analyzed, but also other factors that were mentioned during the review of the literature, fiscal policies can be reformed with the aim of orienting taxpayers towards the correct declaration and payment of taxes. Taxpayers need more information about the types of taxes, the deadlines for payment and declaration, penalties in case of violations, as well as about the possible controls related to the declaration of taxes. It is necessary for the state with its own policies to consider taxpayers as integral and necessary collaborators of the tax system, and not as objects of strict and penal controls. A further study can focus more on other factors, such as the tax culture of the country, the attitude of taxpayers towards tax changes, social or demographic aspects that have to do with the taxpayer as an individual and as part of society, etc. This current study was

limited because of difficulties in reaching valuable data, as information about tax evasion is prevented by a lack of tax culture for self-declaration of income and other factors that can be studied in a further research paper. In conclusion, we suggest that Albania be oriented towards comparison with the countries of the region in relation to policy-making and the determination of TRs or tax procedures, with the aim of improving and aligning these policies as soon as possible with the policies of the EU where it intends to join. To make this possible, a great deal of work is needed to reduce the informal economy, tax evasion, the phenomenon of money laundering, corruption and some other necessary indicators to enable the country's integration into the EU as soon as possible. This study should be followed by other studies in this field in developing countries such as Albania, as factors that help minimize tax evasion should be found. Developing countries face strong challenges due to the inability to implement sustainable policies. Many indicators and factors, procedures and policies, and processes such as digitization, certification, and standardization, which can have a positive effect on reducing tax evasion, should be identified. In a further study, we can make a comparison of the determining factors of tax evasion in Albania compared to other countries of the Western Balkans such as Kosovo, Macedonia, Montenegro, Bosnia and Herzegovina, etc. This can help in suggesting similar effective policies to minimize tax evasion.

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