

Strategies for Addressing Tax Evasion from the Standpoint of EU Tax Rates

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Abstract. *Tax evasion is a major challenge for the sustainability of public finances and the fairness of tax systems. This paper investigates the relationship between tax rates and tax revenue in the European Union, with a particular emphasis on the role that tax evasion plays in this relationship. Using an empirical analysis based on panel data covering the period 2012–2023, this study examines the impact of statutory and effective tax rates, trade openness, economic development, structure of tax revenues, digitization of public administration, governance quality, and the level of total tax revenues. The findings suggest that statutory tax rates do not properly explain the differences in tax revenues across countries. In contrast, effective average tax rates offer a better measure of the fiscal burden actually experienced by taxpayers. Altogether, the report's findings indicate that sustainable improvements in tax revenue in the European Union rely less on changes to statutory tax rates and to a greater extent on consolidating tax administration. These conclusions contribute to strengthening institutional capacity and combating tax evasion in the form of structural and targeted governance reforms. This study makes a contribution to the existing literature by providing empirical evidence from the European Union and by highlighting the importance of effective taxation and governance in the process of achieving sustainable public revenues.*

Keywords: fiscal policy, tax revenue, tax structure, tax evasion, panel data models.

Introduction

Tax evasion is one of the most persistent economic problems facing countries globally. It affects budget revenues, tax fairness and the stability of tax systems. The level of tax rates is frequently cited as a determinant of taxpayers' tax compliance decisions. Thus, this article explores the relationship between the level of tax rates and tax evasion trends, with the overall objective of analyzing how the structure of tax systems influences taxpayer behavior at the European Union ("EU") level.

Tax evasion is found in different forms and manifestations, such as under-declaration of income, under-assessment of the value of assets, misuse of tax deductions, concealment of economic activities and others. Addressing these forms of expression of tax evasion will allow to understand the strategies and methods used by taxpayers to avoid paying taxes.

Statutory tax rates are the level of taxes set by law by the tax authorities. They include income taxes, corporate taxes, VAT and other taxes and contributions. The effective tax rates are the actual level of taxes paid by taxpayers after deductions, tax concessions and other adjustments. They may differ significantly from statutory tax rates. By analyzing the forms of expression of tax evasion and assessing the influence of tax rates (both statutory and effective), the aim is to understand the relationship between the tax system and tax evasion behavior.

It is necessary to make a distinction between tax avoidance and tax evasion. Tax avoidance involves using legal methods and loopholes in the law to minimize tax liabilities without breaking the law. Meanwhile, tax evasion involves unlawful practices to deliberately hide taxable income or distort financial information with the aim of reducing tax obligations. Both of these phenomena

can lead to a decline in public revenue. While tax avoidance is a form of strategic tax planning within the legal framework, tax evasion is usually associated with underground economic practices and fraudulent actions. This distinction is relevant for interpreting the empirical results, since the indicators used in this research primarily capture the effects linked to tax compliance and tax evasion, rather than those associated with legal tax optimization methods.

Tax evasion remains a major challenge for the world's governments, and the level of tax rates is often seen as a determining factor in taxpayers' decisions on whether or not to comply with tax obligations.

The first part of the article consists in a literature review, where numerous studies have examined the impact of tax evasion. Subsequently, the research methodology is analyzed, where the database used is presented, as well as the descriptive statistics, the correlation matrix, and the regression models. The econometric findings are further explained by their economic implications. The paper ends with conclusions, future research directions, and research limitations.

Literature review

The literature emphasizes the importance of the relationship between tax pressure and tax avoidance behavior. The Allingham-Sandmo (1972) model theoretically grounds the tax avoidance decision as a risk calculation. Subsequent empirical studies have shown a negative correlation between the level of tax rates and tax compliance, especially in countries with weak institutions and low levels of transparency. It is also noted that countries with single rates tend to have a simpler system, which may reduce tax avoidance opportunities. Based on the Allingham-Sandmo model (1972), Slemrod (2019) develops a wider theory in which the probability of being subject to a tax audit, the severity of penalties, and tax rates continue to be key drivers.

Sen Gupta's (2007) study complements the existing empirical literature regarding the main driving factors of tax revenue growth in developing economies. The author uses a panel dataset that covers 105 developing countries over 25 years. The results confirm that structural factors such as per capita Gross Domestic Product ("GDP"), agriculture share in GDP, trade openness and foreign aid significantly affect revenue performance of an economy. Other factors include corruption, political stability, share of direct and indirect taxes etc.

Vintila et al. (2018) examine the determinants of the effective corporate income tax rate for a sample of companies listed on five stock exchanges in Eastern Europe, covering the period 2000-2016. The empirical research covers variables related to company characteristics, company-level controls, audit fees, and the statutory rate. The estimated panel data models support a positive link between corporate income tax and profitability, debt, capital and inventory intensity, firm size, and statutory rate, reinforcing the validity of political cost theory. Studies conducted by other authors highlight the increasing influence of both institutional transparency and digitalization on decreasing tax evasion. For example, Fanea-Ivanovici et al. (2019) discuss the role of digitization, with a focus on digital public services and e-government, in increasing tax compliance and combating corruption to improve sustainable development in Romania. In Romania, the first real steps in digitizing public services were taken in 2012. This is the main reason why the collection and reporting of data on digital public services does not cover a longer period of time, which would allow for quantitative analysis. Similarly, Petras (2024) considers the VAT gap as a dependent variable and examines the influence of individuals' e-government activities via websites as an independent variable, as a relevant indicator of digitization. The research methodology consisted of EViews Granger causality tests for data collected from EU sources over a ten-year period (2012-

2021). The research results highlight the potential of digitization in terms of increasing tax compliance and improving VAT collection.

The work of Padurean and Catarama (2010) investigates, in particular, the case of Romania, which switched in 2005 from a progressive system to a flat rate of 16% for personal income and profits. Through an empirical analysis of macroeconomic indicators from the pre- and post-reform periods (including the collection rate, budget revenues, and the level of the underground economy), the authors show that, in the first years after the introduction of the flat tax, there were increases in tax revenue collection, supported both by the revitalization of the economy and by the simplification of tax compliance tasks.

With regard to international tax avoidance, Cobham and Jansky (2018) analyze the revenue losses resulting from tax optimization by large corporations, while Beer et al. (2020) classifies the main channels through which transnational tax avoidance manifests itself. These studies support the idea that simply adjusting tax rates is not enough in the absence of effective tax governance and international cooperation. In addition, Fjeldstad and Heggstad (2012) show, in an African context, that the efficiency of local revenue mobilization depends more on administrative capacity than on tax structure.

A significant contribution to understanding the size of the global underground economy is provided by Medina and Schneider (2018), who estimate the size of informal economies in over 150 countries for the period 1991-2015. The authors' study uses a robust MIMIC (Multiple Indicators Multiple Causes) methodology, highlighting the close link between the level of tax evasion and factors such as the tax burden, the quality of institutions, and the degree of urbanization. The authors show that emerging economies, particularly those in Eastern Europe and Latin America, have the highest levels of informal activity, indicating a significant correlation between the level of tax compliance and institutional stability. These findings reinforce the fact that tax evasion needs to be considered within the overall macroeconomic and legislative context in which it is taking place.

Latest research highlights the importance of both technological development and institutional factors in shaping tax evasion and taxpayer compliance. For example, Masca and Chis (2023) examine the connection between the shadow economy, tax evasion, and wealth inequality in the EU, based on a panel database which covers 28 EU countries from 2005 to 2017. Their findings suggest that informal economic activity at the national level appears to help reduce inequality in income. Since international tax evasion linked to offshore operations exacerbates income inequality, the role of cultural variables in this context is to moderate this relationship. At the same time, a study published by Allam et al. (2024) investigates the link between financial development and tax evasion across 156 countries (OECD and non-OECD countries) from 2000 to 2017. The results suggest that the adoption of fiscal monitoring mechanisms enhances transparency and substantially limits abusive practices, such as the manipulation of financial results and tax evasion. Those outcomes point to both the quality of institutions and innovation in technology as key factors in tax collection and tax performance in today's economies.

The existing literature provides extensive theoretical and empirical evidence on the determinants of tax compliance, tax evasion, and tax revenue performance. There is a wealth of international data on tax evasion and the underground economy. However, there are few empirical studies that focus specifically on EU member states, employing a comparative panel approach that simultaneously takes into account openness to international economic flows, governance quality, and tax structure.

Methodology

The empirical study examines the relationship between the influence of effective tax rates, statutory tax rates and other indicators on tax revenues as a share of GDP. The database covers the period 2012-2023 (2012 is the first year of public data for Corruption Perceptions Index and 2023 is the most recent year with complete data for all variables) and includes EU countries, obtained from publicly available sources such as the World Bank, European Commission, Transparency International.

The following table presents the dependent variable and independent variables used in the empirical research.

Table 1. Description of the variables

Acronym	Variables	Definition	Source
Dependent variable			
TAX_REV	Tax revenue (% of GDP)	Tax revenue (% of GDP) is cash receipts from taxes, social contributions, and other revenues such as fines, fees, rent, and income from property or sales.	World Bank
Independent variables			
STAT_RATE	Statutory tax rate (%)	Statutory tax rate (%) is the legal rate set by national tax legislation applicable to the taxable profit of companies, before applying deductions, tax credits, or special tax breaks. The values presented are for top statutory corporate income tax rates (including surcharges).	European Commission
EATR	Effective tax rate (%)	EATR (%) represent the actual percentage level of taxes paid by taxpayers based on deductions, tax breaks, and other adjustments. The values presented are the effective average tax rates, for large corporations in non-financial sector, computed at corporate level, for average asset composition and funding sources, using the Devereux/Griffith methodology.	European Commission
GDP	GDP per capita (USD)	GDP per capita (USD) is gross domestic product divided by the population at mid-year.	World Bank
TRADE	Trade (% of GDP)	Trade (% of GDP) is the sum of exports and imports of goods and services.	World Bank
TAXES_GS	Taxes on goods and services (% of revenue)	Taxes on goods and services (% of revenue) are taxes levied on the production, leasing, delivery, sale, purchase or other change of ownership of a wide range of goods and the provision of a wide range of services.	World Bank
TAXES_IPC	Taxes on income, profits and capital gains (% of revenue)	Taxes on income, profits, and capital gains (% of revenue) are taxes payable on the actual or presumed incomes, profits and capital gains.	World Bank
EGDI	E-Gov Development Index	E-Gov Development Index incorporates the access characteristics, such as the infrastructure and educational levels, to reflect how a country is using information technologies to promote access and inclusion of its people. The EGDI is a composite measure of three important dimensions of e-government, namely: provision of online services, telecommunication connectivity and human capacity.	World Bank

Acronym	Variables	Definition	Source
CPI	Corruption Perceptions Index	Corruption Perceptions Index ranks 180 countries and territories around the world according to perceived levels of public sector corruption, assigning a score on a scale from 0 (very corrupt) to 100 (very clean).	Transparency International

Source: Author's own research.

The paper employs a multivariate regression model on panel data, in line with the framework proposed by Brooks (2008). Multivariate panel data regression was approached by Brooks in the general form as follows.

$$y_{it} = \alpha + \beta x_{it} + u_{it}, \text{ where:}$$

- y_{it} – endogenous variable;
- x_{it} – exogenous variable;
- α – constant;
- u_{it} – time-varying random component;
- $i = 1, \dots, N$, and N is the size of the sample of countries;
- $t = 1, \dots, T$, and T is the size of the time series.

The modelling of the impact of selected indicators on Tax revenue (% of GDP) is carried out in the form of a multiple regression with panel data where Tax revenue (% of GDP) is the dependent variable and selected indicators (Statutory tax rate (%), EATR (%), GDP per capita (USD), Trade (% of GDP), Taxes on goods and services (% of revenue), Taxes on income, profits and capital gains (% of revenue), EGDI, CPI) are the independent variables. The data is processed using Microsoft Excel and the regression analysis is conducted using EViews 10.

Results and discussions

Figure 1 highlights the comparative evolution of statutory tax rates and effective corporate income tax rates between 2012 and 2023. The evolution of tax rates shows a persistent difference between the statutory and effective corporate income tax rates, indicating the existence of structural mechanisms (e.g., tax deductions, facilities, exemptions) that reduce the actual tax burden on companies. The downward trend observed after 2017 suggests a shift in public policy towards stimulating investments.

Although tax evasion is not directly observable in Figure 1, the persistent difference between the statutory and effective tax rates can be interpreted as a potential space for tax avoidance and tax evasion. The gradual expansion of this deficit points to weaknesses in the tax systems and a possible increase in tax evasion.

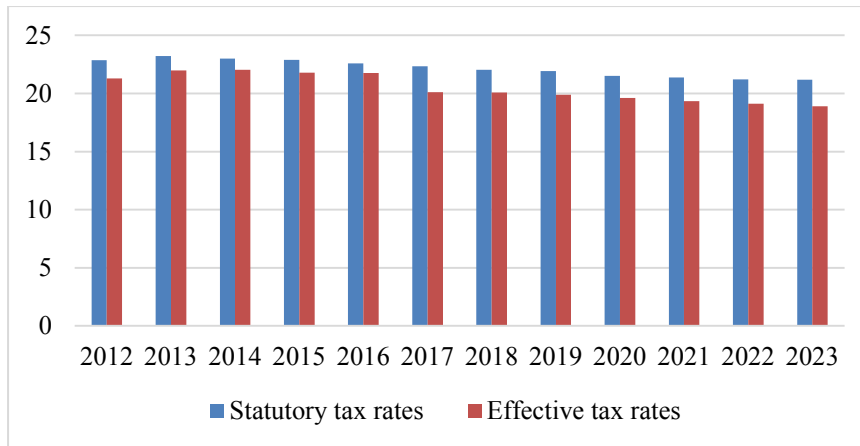


Figure 1. Evolution of the statutory vs. effective tax rates during the period 2012-2023

Source: Author's own research.

Based on the dependent and independent variables selected, the following descriptive statistics were determined.

Table 2. Summary statistics of the variable

Variables	Mean	Median	Maximum	Minimum	Std. dev.	Observations
CPI	63.73	60.00	92.00	36.00	14.35	324
EATR	20.50	19.49	38.56	9.45	6.37	324
EGDI	0.79	0.80	0.98	0.54	0.09	324
GDP	10.29	10.24	11.81	8.89	0.61	324
STAT_RATE	22.18	21.00	44.40	10.00	6.93	324
TAX_REV	21.35	21.83	36.59	10.64	4.83	324
TAXES_GS	32.60	32.39	50.20	19.13	6.52	324
TAXES_IPC	22.51	19.55	49.72	5.69	9.63	324
TRADE	4.79	4.83	6.02	3.99	0.44	324

Source: Author's own research.

Logarithmic transformations were selectively applied to GDP and TRADE variables to reduce distribution asymmetry and the influence of extreme values, while other variables were kept at their original levels to preserve economic interpretability.

The correlation matrix below highlights the interdependencies among the variables used in the empirical modeling, the way these variables influence one another, the strength of these connections, and their direction.

Table 3. Correlation matrix

Variables	CPI	EATR	EGDI	GDP	STAT_RATE	TAX_REV	TAXES_GS	TAXES_IPC	TRADE
CPI	1								
EATR	0.32	1							
EGDI	0.64	0.20	1						
GDP	0.80	0.42	0.65	1					
STAT_RATE	0.29	0.92	0.29	0.39	1				
TAX_REV	0.31	0.16	0.28	0.38	0.23	1			
TAXES_GS	-0.30	-0.62	-0.31	-0.55	-0.56	0.04	1		
TAXES_IPC	0.43	0.29	0.35	0.65	0.32	0.53	-0.51	1	
TRADE	0.08	-0.24	-0.05	0.23	-0.24	0.07	0.05	0.28	1

Source: Author's own research.

It can be seen in Table 3 high values in the correlation matrix recorded between EATR and STAT_RATE, CPI and EGDI/GDP, EGDI and GDP, but these were deployed in different regressions, so the high correlations were removed. At the same time, there are low correlated variables, but these were used because the goal of the study is to study the drivers of influence, regardless of their power.

Taking into account the multinational and temporal structure of the sample, an econometric approach with panel data was applied. Panel models provide a number of advantages over approaches based solely on cross-sections or time series. This is because these models allow for the control of undetected heterogeneity among countries while capturing temporal patterns. This approach improves the accuracy of the predictors and lowers the risk of systematic error caused by omitted variables. In order to identify the optimum panel specification, both fixed-effects and random-effects models were estimated and afterwards compared through the Hausman test. Furthermore, the aggregated panel estimates, with robust standard errors, served as reference specifications to enable comparability for the various model formulations.

As part of the quantitative analysis, a multivariate regression is performed using panel data to identify how the independent variables (CPI, EATR, EGDI, GDP, STAT_RATE, TAXES_GS, TAXES_IPC, TRADE) impact the dependent variable (TAX_REV).

Table 4. Data panel regression coefficients

Independent variables	Equations					
	Eq. 1	Eq. 2	Eq. 3	Eq. 4	Eq. 5	Eq. 6
CPI	0.04* (11.14)			0.03* (9.84)		
EATR				0.21* (10.47)	0.23* (11.91)	0.19* (9.11)
EGDI		6.52* (5.15)			8.13* (7.09)	
GDP			1.90* (13.84)			1.82* (11.72)
STAT_RATE	0.19* (12.16)	0.19* (12.89)	0.18* (10.72)			
TAXES_GS	0.44* (41.52)	0.45* (44.92)	0.49* (55.11)	0.46* (30.70)	0.48* (34.53)	0.50* (45.45)
TAXES_IPC	0.37* (20.47)	0.37* (18.97)	0.33* (18.92)	0.38* (22.30)	0.37* (20.09)	0.35* (20.81)
TRADE	-1.14* (-9.53)	-0.97* (-8.50)	-1.55* (-12.35)	-1.24* (-9.04)	-0.95* (-7.72)	-1.64* (-12.39)
C	-2.48* (-3.11)	-6.37* (-5.58)	-18.21* (-15.80)	-2.62* (-2.54)	-9.25* (-7.52)	-17.54* (-15.05)
R-squared	0.500	0.504	0.520	0.494	0.508	0.512
F-statistic	63.72	64.75	68.77	62.11	65.55	66.79
Prob(F-statistic)	0.00*	0.00*	0.00*	0.00*	0.00*	0.00*
Observations	324	324	324	324	324	324
Countries	27	27	27	27	27	27

Notes: * indicate statistical significance at the 1% significance level. Each variable is presented with the associated coefficient value and the t-statistic value in parentheses.

Source: Author's own research.

The econometric model is estimated using panel data covering 27 EU member states for the period 2012-2023. The benchmark estimate is computed using the Panel Least Squares method, with standard errors adjusted for White's cross-section to allow for heteroscedasticity cross-

country. In order to identify the optimum panel specification, both fixed-effects and random-effects models were estimated and afterwards compared through the Hausman test. The results of the test suggest that the null hypothesis cannot be rejected, indicating that the random-effects estimator is robust and valid. Therefore, the random-effects panel model was chosen as the most appropriate specification for the econometric analysis.

The results of the first regression model indicate that the CPI has a positive and statistically significant effect on tax revenues (TAX_REV), suggesting that lower levels of corruption are associated with a higher capacity to collect tax revenues. This observation supports the theory that increasing the quality of governance and improving compliance with tax obligations helps reduce tax evasion. The statutory tax rate (STAT_RATE) also has a positive and significant impact, pointing to the fact that the formal tax rate influences potential tax revenue (TAX_REV). The variables measuring the tax structure, namely taxes on goods and services (TAXES_GS) and taxes on income, profits, and capital gains (TAXES_IPC), have significant and positive coefficients, meaning that the proportion of these categories in the tax system plays a major role in determining tax revenues (TAX_REV). On the other hand, trade openness (TRADE) has a negative effect, implying that extremely open economies are more vulnerable to the erosion of the tax base and tax evasion.

In the second regression model, the Public Administration Digitalization Index (EGDI) shows a significant and positive coefficient, highlighting the fact that the digitalization of public administration and tax systems enhances the efficiency of tax collecting. This outcome confirms the assumption that digitization decreases the costs of compliance and reduces the possibilities for tax evasion. In line with the previous model, the statutory tax rate (STAT_RATE) and the tax structure (TAXES_GS, TAXES_IPC) have positive and robust effects, meanwhile the TRADE variable continues to have a negative impact, reinforcing the vulnerability of open economies towards tax revenue losses.

The third regression model reveals the effect of economic progress, as measured by GDP per capita. The coefficient linked to this variable is positive and significant, revealing that developed economies possess stronger institutional and administrative capacities, which facilitate tax revenue collection. The results regarding the statutory tax rates (STAT_RATE) and the structure of taxation (TAXES_GS, TAXES_IPC) remain consistent with the other models, reinforcing the idea that the structure of the tax system is more important than the nominal level of rates. The negative effect of trade openness (TRADE) persists in this panel model as well.

Empirical results suggest that reducing tax evasion and increasing tax revenues in EU countries cannot be achieved solely by adjusting tax rates, but requires strengthening institutions, digitizing tax administration, and optimizing the structure of the tax system. Overall, the estimates show that tax revenues are influenced to a greater extent by institutional quality, digitization, and the structure of the tax system than by the formal level of tax rates.

To better reflect the actual tax burden faced by taxpayers, the statutory tax rates (STAT_RATE) have been replaced with the effective average tax rate (EATR) in regression models (4) - (6). This adjustment gives a more realistic evaluation of the relation between tax policy and tax revenue levels, particularly in light of the differences between nominal and effective tax rates. In comparison with the regression models built on statutory rates, the regression models that include the EATR provide more balanced coefficients, meaning that the EATR better reflects the fiscal burden. The statistical significance of EATR in all three models supports the argument that differences between nominal and effective rates are essential for understanding tax performance in the EU states.

In conclusion, these results suggest that effective tax rates, along with institutional and structural characteristics, are the main drivers of tax revenue in EU member states. Digitalisation of public services and the quality of institutions strengthen the effect of fiscal policy, whilst trade liberalisation adds pressure to the tax base.

Conclusion

The study presented analysed the correlation between tax rates and tax revenues in EU countries regarding tax evasion and tax collection efficiency, employing an econometric panel framework during the period 2012-2023. The results obtained highlight the fact that the level of tax revenues is not determined exclusively by the size of tax rates, but by the interaction between economic, institutional, and structural factors.

A first relevant result is the difference in impact between statutory rates and EATR. The empirical analyses point out that EATR provides a better picture of the fiscal burden than statutory rates, supporting the existence of a continuous gap among statutory and effective tax rates. This gap could be explained by tax loopholes, tax planning mechanisms, and tax evasion practices, indicating that fiscal policies centered on nominal rate changes alone have limited impact in terms of increasing government revenue.

Secondly, the findings underline the relevance of the tax revenue structure. Taxes on goods and services, in addition to income, profit, and capital gains taxes, show a statistically significant positive effect on total tax revenue. This underscores the critical role of a well-balanced fiscal framework in ensuring the stability and sustainability of public funds. Economies that succeed in diversifying their sources of tax revenue are better able to withstand economic shocks and tax evasion.

Another key conclusion relates to the role of institutional and administrative factors. Indicators on governance and digitalization show that countries with better tax administrations and greater digitalization are able to collect larger amounts of tax revenue, despite having moderate tax rates. This finding provides further support for the hypothesis that a reduction in tax evasion is achieved more effectively by consolidating administrative capacity and promoting transparency than by simply increasing the tax burden.

Moreover, the negative association between trade openness and tax revenues implies that economic integration into the worldwide economy may increase the chances of tax base erosion, especially through capital mobility and tax competition among countries. This underlines the necessity of closer tax coordination at the EU level to limit profit-shifting strategies and harmful tax competition.

Finally, the study's findings support the idea that the effectiveness of tax collection in EU countries relies more on the quality of institutions, the organization of the tax system, and the level of voluntary tax compliance than on the actual level of tax rates. Tax policies designed to combat tax evasion, digitalise administration, and consolidate the tax base are critical to achieving sustainable growth in government revenues while avoiding negative impacts on economic competition.

Notwithstanding the important conclusions drawn based on this study, several limitations must be acknowledged. First, the study depends on publicly available information obtained from global sources. Therefore, discrepancies in data collection among countries and over time might affect the study's accuracy and comprehensiveness. Second of all the analysis is limited to the period 2012-2023 because 2012 is the first year of public data for CPI index.

Future research could, for example, include comparing EU countries with a flat tax rate to those with a progressive tax system. Similarly, analyzing tax evasion in different economic sectors

(e.g., multinational corporations) might reveal sector-specific weaknesses and could serve as the basis for tailored policy measures.

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