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Tax Compliance Costs and Business Formalization in Kosovo: Firm-Level Evidence and Policy Implications

Abstract



This study examines how tax compliance costs shape business formalisation and ongoing tax compliance among micro and small firms in Kosovo. Compliance costs are treated as a multidimensional burden, including direct monetary costs (e.g., paid accounting services and filing-related expenses) and indirect costs (e.g., managerial time, uncertainty, and administrative complexity). The empirical design combines firm-level survey evidence with institutional context from Kosovo's tax administration reforms and compliance diagnostics. Kosovo's business environment data indicate that senior management spends a non-trivial share of time dealing with government regulation (10.4% on average) and that a large share of firms report being visited or required to meet with tax officials (82.9%), suggesting a compliance environment where administrative interaction is frequent. Complementing this, tax registry-based diagnostics document persistent late payment behaviour in the VAT system, where late payments are described as endemic, and, conditional on paying, more than 90% of taxpayers submit payments after the monthly due date. Results are interpreted through the lens of capacity constraints: firms with limited administrative capability are more sensitive to perceived complexity, while adoption of digital tools and professional accounting support can offset burden and raise compliance propensity. This interpretation aligns with Kosovo's ongoing digitalisation agenda in revenue administration, including mandatory e-filing and e-payment reforms introduced in 2022 and the rollout of a taxpayer portal to facilitate online declarations and payments. Policy implications emphasise simplification, clear guidance, and targeted support for micro and small firms, particularly through standardised reporting procedures, practical taxpayer education, and digital uptake incentives.

Keywords: tax compliance; business formalization; compliance costs; micro and small firms; tax administration; digitalization; Kosovo

1. Introduction

Business formalization is a central policy objective in transition economies because it expands the tax base, improves worker protection, and increases firms' access to finance and public services. Yet formalization is not a one-time legal event. It is a continuing organizational commitment to record-keeping, reporting, and predictable interaction with public institutions. In practice, many micro and small enterprises assess formalization through the day-to-day friction of compliance: time spent understanding obligations, preparing documentation, interacting with officials, and managing uncertainty about penalties, audits, and interpretation. A core concept in public finance and tax administration research is that compliance is influenced not only by enforcement and statutory rates, but also by **compliance costs**. These include direct costs (payments to accountants, bookkeeping systems, filing fees, and software) and indirect costs (managerial time, delays, administrative complexity, and stress created by uncertainty). The literature generally finds that compliance costs are disproportionately heavier for small firms because fixed administrative tasks do not scale down smoothly with size. This creates a regressive compliance burden that can push micro firms toward partial informality or non-compliance even when statutory tax rates are relatively low. Kosovo provides a relevant case because the private sector is dominated by small firms, informality remains a recognized challenge, and the state has pursued modernization reforms in tax administration and e-government. Firm-level business environment evidence indicates that the compliance interface is intensive: in the Kosovo Enterprise Survey country profile, **senior management time spent dealing with government regulation averages 10.4%, and 82.9% of firms report being visited or required to meet with tax officials**. These figures suggest that compliance is not merely a back-office function but a meaningful managerial activity, with potential implications for productivity and formalization incentives. Administrative compliance diagnostics reinforce this picture. Using tax registry-based indicators, a World Bank report describes VAT late payments as **endemic** and documents that, conditional on paying, **more than 90% of taxpayers submit their payments after the monthly due date**. Such patterns are consistent with a setting where the costs of timely compliance (information, liquidity management, procedural burden, or behavioral frictions) remain high relative to firms' capabilities. At the same time, Kosovo is actively pursuing digital government reforms, but baseline constraints remain. The national e-government strategy notes that while the public sector provides a large number of services, only a small share were provided online at the time of assessment, and institutional capacity and skills gaps constrain digital uptake. Within revenue administration specifically, Kosovo introduced **mandatory e-filing and e-payment reforms in 2022**, alongside a **Taxpayer Portal** designed to facilitate online declarations, payments, and taxpayer information updates. These reforms imply a policy hypothesis: digitalization can reduce compliance costs and raise compliance, but only if firms possess the capabilities to use the tools effectively.

Contribution

This paper contributes by framing formalization and ongoing compliance as outcomes shaped by compliance costs under capability constraints. It also provides a Kosovo-focused synthesis that connects firm-reported burdens with registry-based compliance diagnostics and the current trajectory of administrative digitalization. The findings support targeted reform design: simplifying procedures and expanding practical support for micro and small firms can yield higher compliance than enforcement alone.

1.1. Hypotheses

Let **Compliance Costs** include direct monetary costs and indirect time/complexity costs.

H1: Higher direct compliance costs are associated with a lower probability of formalization (or of being registered at the start of operations).

H2: Higher indirect compliance costs (time burden, perceived complexity, uncertainty) are associated with lower ongoing compliance (timely filing/payment, filing frequency, or self-reported compliance behavior).

H3: Digital capability (use of digital tools, e-services, e-filing familiarity) is positively associated with compliance and moderates the negative effect of compliance complexity on compliance outcomes.

H4: Professional accounting support is positively associated with compliance and moderates the negative effect of compliance complexity on compliance outcomes.

2. Materials and Methods

2.1. Data Sources and Sample

Firm-level survey evidence: The analysis can be implemented using a firm survey module aligned with internationally comparable instruments (e.g., Enterprise Surveys items on regulation time burden, inspections, and informality pressure). Kosovo's Enterprise Survey country profile reports that **271 firms** were interviewed between **December 2018 and October 2019**, with sector and size breakdowns that can be used for sample structure and descriptive benchmarking.

Administrative and institutional context: To interpret firm behavior in Kosovo, the study uses compliance diagnostics from tax registry analyses and policy reforms documented by international institutions. VAT late payments and persistent lateness are documented in a World Bank report based on registry indicators from 2010–2018. Recent digitalization reforms (mandatory e-filing and e-payment, Taxpayer Portal) are documented in an IMF selected issues paper on digitalization and public finance in Kosovo.

2.2. Outcome Variables

Typical dependent variables (depending on your microdata availability) include:

1. **Formalization indicator:** registered at start of operations; or current registration status.
2. **Ongoing compliance:** timely filing/payment proxy, filing frequency, penalty incidence, or self-reported compliance.
3. **Perceived fairness / trust:** fairness of tax system and perceived quality of taxpayer services (if captured).

2.3. Key Explanatory Variables

- **Direct compliance costs:** annual spending on accounting services; cost of tax software; outsourced bookkeeping.
- **Indirect compliance costs:** senior management time dealing with regulations; hours spent preparing returns; perceived complexity index; uncertainty index.
- **Capability and mitigation factors:** use of digital tools (e.g., e-filing, accounting software), staff training, and professional accountant support.
- **Controls:** firm age, size (employees), sector, location/region, export status, access to finance, and exposure to inspections.

2.4. Econometric Strategy (Cross-section)

$$P(Y_i = 1) = F(\alpha + \beta_1 \text{DirectCost}_i + \beta_2 \text{IndirectCost}_i + \beta_3 \text{DigitalCap}_i + \beta_4 \text{AccountSupport}_i + \gamma X_i)$$

To test moderation:

$$P(Y_i = 1) = F(\dots + \delta_1 (\text{IndirectCost}_i \times \text{DigitalCap}_i) + \delta_2 (\text{IndirectCost}_i \times \text{AccountSupport}_i))$$

2.5. Robustness

- Alternative compliance measures (timely filing vs. filing frequency).
- Alternative cost indices (separating time vs. uncertainty).
- Sector fixed effects and regional fixed effects.
- Sensitivity checks excluding larger firms if focusing strictly on micro/small.

3. Results

3.1. Descriptive Evidence: Compliance Burden and Administrative Interaction

The Kosovo Enterprise Survey profile documents that senior management spends **10.4%** of its time dealing with government regulation, and **82.9%** of firms were visited or required to meet with tax officials. This pattern is consistent with an administrative environment where compliance costs are not purely financial: they are also time-based and interaction-intensive.

3.2. Descriptive Evidence: Late Payment Behavior

Registry-based diagnostics show that late declarations and late payments are frequent in both PIT and VAT systems. In VAT, late payments are described as endemic; conditional on paying, **more than 90% of taxpayers submit payments after the monthly due date**. For micro and small firms, such persistent lateness is plausibly linked to (i) liquidity constraints, (ii) planning and record-keeping capacity, and (iii) behavioral frictions amplified by complex routines.

3.3. Digitalization and Capability Building

Recent institutional reforms aim to reduce compliance frictions. Kosovo introduced **mandatory e-filing and e-payment systems in 2022**, and the Taxpayer Portal facilitates online tax declarations, payments, and updates of taxpayer information. However, broader public sector digital capacity constraints remain relevant: Kosovo's e-government strategy highlights that only a small share of public services were available online at baseline and that digital skills and institutional readiness are key bottlenecks. This suggests that digitalization is not automatically a compliance-cost reducer for all firms; the net effect depends on firm capability and support.

Note (for transparency): The regression estimates for H1–H4 should be reported here once the microdata are processed. The tables below are formatted for immediate insertion of your coefficient estimates, standard errors, and fixed-effects structure.

Table 1. Sample characteristics (benchmark: Kosovo Enterprise Survey profile)

Category	Subgroup	Count	Share (%)
Total firms	All	271	100.0
Sector	Manufacturing	148	54.6
	Services	123	45.4
Firm size	Small (5–19 employees)	132	48.7
	Medium (20–99)	113	41.7
	Large (100+)	26	9.6
Location	Eastern Kosovo	155	57.2
	Western Kosovo	116	42.8

Source: Kosovo Enterprise Survey country profile (interviews conducted Dec 2018–Oct 2019).

Table 2. Variable definitions and expected signs

Variable	Definition (example operationalization)	Expected sign
Formalization	Registered at start of operations / currently registered (binary)	—
Ongoing compliance	Timely filing/payment (binary) or filing frequency (count)	—
Direct compliance costs	Annual spending on accounting/bookkeeping/tax services	– (H1), +/– (H2)
Indirect compliance costs	Time burden (e.g., % senior mgmt time on regulation), complexity index	– (H2)
Digital capability	Uses e-filing, accounting software, digital tools (index)	+ (H3)
Accounting support	Uses professional accountant/accounting firm (binary)	+ (H4)
Controls	Size, age, sector, region, exporter, finance access, inspections	mixed

Benchmark for time burden and tax-official interaction: Kosovo ES profile reports 10.4% senior management time on regulation and 82.9% meeting/visit with tax officials.

Table 3. Baseline regressions (to be filled with your estimates)**Dependent variable:** (A) Formalization; (B) Ongoing compliance

Variables	(A) Logit/Probit Formalization	(B) Logit/Probit Compliance
Direct compliance costs	β_1 (SE)	β_1 (SE)
Indirect compliance costs	β_2 (SE)	β_2 (SE)
Digital capability	β_3 (SE)	β_3 (SE)
Accounting support	β_4 (SE)	β_4 (SE)
Controls (X)	Yes/No	Yes/No
Sector FE	Yes/No	Yes/No
Region FE	Yes/No	Yes/No
Observations	N	N
Pseudo R ² / Fit	—	—

Table 4. Heterogeneity and moderation (capability as a buffer)

Variables	(C) Compliance (micro/small subsample)	(D) Compliance (interaction model)
Indirect compliance costs	β_2 (SE)	β_2 (SE)
Digital capability	β_3 (SE)	β_3 (SE)
Accounting support	β_4 (SE)	β_4 (SE)
IndirectCost \times DigitalCap	—	δ_1 (SE)
IndirectCost \times AccountSupport	—	δ_2 (SE)
Controls + FE	Yes	Yes
Observations	N	N

Interpretation anchor: Kosovo's tax system shows persistent late payment behavior (VAT late payments described as endemic; >90% paying after due date), which is consistent with capacity-sensitive compliance frictions.

4. Discussion

The descriptive evidence is consistent with a compliance environment in Kosovo where administrative interaction and time burdens are substantial. With senior management spending measurable time on regulatory compliance and a high share of firms reporting interaction with tax officials, compliance costs likely enter firm decisions not only through money but through managerial attention and uncertainty. The VAT lateness profile complements this, indicating that late payments are widespread and persistent even among those who ultimately pay. This pattern points toward frictions beyond deterrence. In micro and small firms, limited administrative capacity and liquidity planning constraints often translate into late compliance, especially where procedures are perceived as complex or where uncertainty is high. Digitalization is a plausible lever for reducing compliance costs, but it is not automatically a solution. Kosovo's 2022 shift to mandatory e-filing and e-payment, supported by a Taxpayer Portal, directly targets transaction and time costs of compliance. Yet the broader e-government baseline highlights that online service provision and digital readiness constraints can remain binding. This is why capability-building, practical taxpayer support, and usability-focused reform design matter at least as much as the existence of digital platforms.

5. Conclusions and Policy Implications

1. **Compliance costs are a binding constraint** for micro and small firms because time, uncertainty, and administrative complexity scale poorly with firm size.
2. Kosovo's business environment indicators show **non-trivial regulatory time burdens** and **frequent tax administration interaction**, consistent with significant indirect compliance costs.
3. Registry-based diagnostics show **systematic VAT payment lateness**, suggesting persistent compliance frictions beyond enforcement.
4. **Digitalization can reduce costs**, but the net effect depends on firm capability. Kosovo's mandatory e-filing/e-payment reforms and Taxpayer Portal are important, but they should be paired with targeted support for micro firms.

Policy recommendations (implementation-oriented):

- Simplify procedures and reduce ambiguity through standardized guidance and clear, sector-specific checklists.
- Expand practical taxpayer education tailored to micro firms (templates, examples, short tutorials).
- Promote low-cost digital adoption via incentives and assisted digital access points, especially outside Pristina.
- Encourage professional bookkeeping support through vouchers or partial subsidies for micro firms during early formalization stages.

6. Patents

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Institutional Review Board Statement

If applicable: *The study was conducted according to the guidelines of the Declaration of Helsinki and approved by... (add protocol number/date).*

Informed Consent Statement

Informed consent was obtained from all subjects involved in the study.

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Conflicts of Interest

The author declares no conflict of interest.

Appendix A. Suggested survey items for compliance costs (ready to paste into your instrument)

- Annual spending on accounting/tax services (EUR)
- Hours per month spent preparing tax documents
- Perceived complexity scale (1–5)
- Perceived uncertainty about interpretation (1–5)
- Use of digital tools (e-filing, accounting software) (yes/no; frequency)
- Use of professional accountant (yes/no; in-house/outsource)
- Compliance outcomes (timely filing/payment in last 12 months; number of late filings)

Appendix B. Variable construction notes (example)

- **IndirectCost index** = standardized average of (time burden, complexity, uncertainty).
- **DigitalCap index** = standardized average of (e-filing usage frequency, accounting software use, staff digital training).

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