

Personal Income Tax Law Changes and the Impact on Family Budget in Albania

Imelda Sejдини

Dr. Assistant Professor, Faculty of Economy, University of Elbasan “Aleksandër Xhuvani”; Correspondence address: Rruga Tomorr Domi, Elbasan, Albania, 3001; e-mail: imelda.sejдини@uniel.edu.al

 <https://orcid.org/0000-0002-9067-1259>

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Abstract: Personal income tax is a tax on wages or salaries and other income a person earns during a calendar year. It is calculated on the income of all resident individuals and each government imposes personal income tax on earnings according to its fiscal package. The taxable incomes has been on focus of the latest fiscal package of Albanian Government approved by the end of December 2019 and starting from January 2020, changes effect a larger category of people. This paper is focused in analyzing the changes of personal income tax law and evaluating the impact on family budget. Considering the effects in the standard of living, this evaluation will show the need for other regulations. Interesting implications will be explored for policy makers and working persons in Albania.

1. Introduction

The objective of this study is to provide an overview of legal tax changes over the years in Albania, to reflect the changes of the economic transition, to analyze and evaluate the impact of these changes on revenue and especially on family budget with the main purpose, to determine what is the impact of legal changes on taxes in the household budget in Albania.

A tax is a compulsory financial charge or some other type of charge imposed on a taxpayer (an individual or a legal entity) by government in

order to fund spending and various public expenditures¹. Taxes are direct or indirect. Direct taxes are primarily taxes on natural persons (e.g., individuals), and they are typically based on the taxpayer's ability to pay as measured by income, expenditures or net wealth. Income tax is a direct tax charged to individuals or entities, paid directly to the government and is collected by central government. In Albania, taxes are imposed by government or local authorities. The most important sources of national income from taxation are corporate income taxes, *personal income taxes*, excise tax, value added tax, national taxes and other, which are all applied at national level. National income is also composed by customs duties and social insurance payments.

Considering law references, every person or entity that acquires a legitimate income, is a taxpayer. Income sources may be different for different people. Taxable incomes are distinguished in some categories. The sources of income in Albania but not only, according to the current law² are: current employment relationship income including wages, salaries and bonuses (excluding diplomatic relationships); income from bank interests or securities; cultural or sport activities income as well as income from other personal activities in Albania; income from nonresident's activities through resident individuals; income from property right transfers considering realty of residents; income from real estate and accessories; income from the right for use of natural resources, minerals and hydrocarbon assets; income from shares and interest; income from dividends distributed by a resident legal entity; income from profit shares related to partnerships, income from copyright and intellectual property, rent or leasing as well as gambling revenue; income of nonresidents from rendering services to residents; other incomes non mentioned above. Some income are excluded, such as: Income earned as a result of insurance in the compulsory social insurance scheme and health, as well as economic assistance to low-income individuals; Student scholarships; Minimum wages; Income received, including income in cash or in kind, from owners as reward for

¹ Charles E. McLure, et.al. "Taxation," Encyclopedia Britannica, accessed April, 21, 2021, <https://www.britannica.com/topic/taxation>.

² Article no. 4 on "Income Sources", of Law No. 8438 date 28 December 1998 on "Income Tax" in Albania, Official Journal of Albanian Republic, No. 154, as amended.

expropriations made by the state for public interests; Income obtained as a result of financial compensation, for former owners and former convicts politics; Contributions made by the employer to ensure the life and health of employees; Compensation benefits, obtained through final court decisions, such as and certain reimbursements for court costs; Revenues excluded under international agreements ratified by the Assembly in Albania; Income obtained from state institutions for achievements in science, sports, culture; Transfer of ownership of agricultural land from a registered farmer to a farmer or natural or legal person carrying out agricultural activity; Contribution made by each member of a voluntary pension fund to the extent specified in the law on voluntary pension funds³, as well as contributions made by the employer or any other contributor, in the name and on behalf of the member of the voluntary pension fund including capital gains from fund assets investments during the administration from the management company up to an amount determined by Law on pensions in force; Compensation received in cases of illness, disasters, in accordance with the provisions of legislation relevant in force. Considering different sources of income, taxation in Albania is applied according to Law No. 8438 dated 28 December 1998 on Income Tax, amended by the Albanian Parliament 45 time since first approval. The most recent change is the one of 23.12.2020, followed by the last normative act no. 20, dated 07.05.2021. These continuous changes during these years show the importance of the role of income taxation in the tax system applied in Albania. The system of collection is built in the way that taxes are collected and paid by the employer by withholding it in the source it is earned.

Considering the role of the government in ensuring social welfare for all the citizens, these changes show the endeavor to have a better distribution of tax burden in order to have the resources better distributed in terms of equality.

As long as income is the most important part of a budget, taxation is an important factor in income reducing. This means that the disposable income to cover the expenses is lower if tax rates increase. This has a very

³ Article no. 88 on "Tax treatment of pension fund members' contributions", of Law No. 10 197, date 10.12.2009, "On voluntary pension funds," Official Journal of Albanian Republic, No. 185, as amended.

important impact in the standard of living of people affected by tax rates increase. This paper will analyze the law changes on personal income tax and will evaluate the impact on family budget.

2. Methodology

For the purpose of this study, secondary data are collected and used by reviewing and analyzing the contemporary literature, laws, reports, studies, and other data collected from official sources of information in Albania.

3. Literature review

Taxes are financial obligations to be paid by citizens or residents in a state, determined by governments as taxing authorities. Taxes are involuntary payments not linked to the provided services, paid on income from different sources, considering work income such as wages, real estate income from rent, income from sale transactions or capital gains. Literature on public finance classifies taxes in many various ways, depending on who pays the taxes. Personal income tax plays an important role in almost all national tax systems. It is the easiest tax to collect by withholding it in source it is earned. Personal tax income revenue is composed by different taxes but the one collected from wages represents a higher percentage and generates considerable revenue, particularly for countries in transition as one of the most important sources of national income from taxation. Determinants of tax revenues differ among countries. Personal income tax is one of the major taxes used by both developed and undeveloped countries (Gruber, 2005).

Evaluations on tax effects on household incomes are considered from different point of views over the years in literature and studies. These taxes are related to income inequalities and income reports from citizens. If countries see the effect of an income tax increase as a mean for reducing inequality among people, this policy may result ineffective because taxpayers may reduce the reported income in response to higher tax rates for increasing progressivity of tax system. The adverse effect may result for lower tax rates, as people tend to report higher incomes.⁴ So, Personal Income Tax (PIT), like every other tax, effect people behavior and this results in

⁴ Gerald Auten and Robert Carroll, "The effect of Income taxes on household income," *The review of economics and statistics*, no. 81(1999): 14.

efficiency implications. The impact is on both, labor supply and savings decisions. PIT may distort these decisions and the way how, is a central consideration in determining the rate and structure of this tax.⁵ Different empirical studies show that this tax tends to reduce incentives of people to work in some cases and in other cases tends to have an adverse effect, as it makes people feel poorer and serves as an induction to work more. The extent, to which these effects eliminate each other, needs a very accurate calculation in order to evaluate the right tax rate to be applied and the impact on countries tax revenues.

High income countries have higher tax revenues and higher GDP per capita (Clausing, 2007) related to middle or low income countries. A large number of studies highlight the importance of an adequate tax system in stimulating economic growth and reducing income inequalities, as changes in the tax and benefit system have an immediate effect. Countries over the years have debated the benefits and drawbacks of progressive taxation over the flat-rate tax system. Literature on taxes shows a number of advantages and disadvantages of progressive taxation and flat-rate taxation as well. The most often mentioned advantage of progressive taxation is the positive effect on income distribution. According to Shapiro 1996⁶, progressive taxation leads to much better fulfillment of the objective of social justice, considering that the people with a low level of income are taxed less than people with high level of income, which leads to the improvement of the living conditions for the individuals at the bottom of the distribution. Conessa and Crueger (2006) show that a progressive tax system enhances an equal distribution of economic welfare.

Albanian tax system has undergone different fiscal reforms over the years and both models, progressive taxation and flat-rate taxation have been applied. The current tax regime in Albania is the progressive taxation, set by the government by considering that individuals with low and medium personal income are negatively affected and individuals that gain more are favored by the previous flat tax. The flat taxation is considered as more

⁵ Howell H. Zee, "PIT Reform: Concepts, Issues, and Comparative Country Developments," *IMF Working paper* 05 no. 87 (April 2005): 1–59.

⁶ Robert J. Shapiro, *Why Fairness Matters: Progressive Versus Flat Taxes* (Washington DC: Progressive Foundation, 1996), 1–44.

favorable for the middle layer of population, but Albania maintains a large misbalance regarding the economic layers. Since individuals with low and medium income make up for the majority of both public and private sector, their contribution to the state budget revenues is greater. In Albania there have been two positive effects by applying the progressive taxation: according to official data, more than 300,000 employees are freed from the burden and charges and more income are accumulated for the state budget. But still, there are a lot of discussion related progressive taxation being fair.

4. An overview of fiscal legislation and tax law amendments in Albania

The concept of the personal income tax, or the individual income tax, until the early 1990s was not introduced in Albania yet. Personal income tax is a new policy in the Albania of 90-s. This concept includes both individual and corporate tax, but in this study, we are going to focus on individual personal income tax.

Personal income tax policy has gone through several series of reforms during 1991–2021, along with the reforms of democratic changes in Albania and it has become a progressively more important source of revenue and a policy instrument in Albania's fiscal taxation system.

Since 1992 with the initiation of adapting a fiscal regime after introducing the first fiscal package in 1991, fiscal facilities were provided as an instrument for promoting private enterprise, followed by a better comprehensive legislation. Some of the fiscal facilities were: tax on profit exceptions; exemptions from customs duties on investment goods; non-application of taxes on dividend, etc. This fiscal regime has evolved periodically. It is consolidated by Law No. 7786 dt.27.01.1994 meeting the threshold of 10,001ALL/month on wages and the modernization of legislation by law 8438 dt.28.12.1998 has followed. In the beginning of 1998, no tax relief is applied anymore. The new fiscal legislation consisted on a unique income tax rate for all types of activities at the rate of 30%, the average applied by OECD countries. The tax on withholding dividend at the rate of 10% is applied for residents (15% is applied for nonresidents). This rate of 10% is also applied to profit distribution, interest and payments on author's right and royalties. This new fiscal legislation also includes some deductible expenditure before profit calculations and taxation. On all machinery and equipment a depreciation rate of

20% is applied. There is no evidence and calculation that proves the positive effects of these fiscal changes or economical benefits. Effects of the implementation of the new fiscal policy have resulted in a significant increase in the state budget revenues from VAT and personal income tax, while budget revenues from economic and trade activity maintain the same descending trends related to GDP.

A new threshold set above 14,000ALL/month on wages by law 8841 dt.11.12.2001 and frequent changes of threshold for progressive taxation were applied since January 2008 (Table 1). A series of additional initiatives took place as part of tax legislation changes and were finalized with the approval of a new fiscal package in the second half of 2007. Some of these changes intended to stimulate business incentives and at the same time generate more tax revenues. Such reforms consisted of the change from a progressive to a 10% flat income (2007) and profit (2008) tax system excluding only law wages up to 30,000ALL/month by setting a threshold up to 10,000ALL/month and no threshold was used for wages over 30,000ALL (Albanian Ministry of Finance, 2008). All other exclusions and facilitations under the old tax system were eliminated⁷. A new amendment made by Law no. 107/2012, dt.15.04.2013 for all wages over 30000 ALL /month to be taxed by 10% without exclusion rate was approved. The burden of exemption from taxation of 0–10,000ALL for wages up to 30,000ALL also changed in 0–30,000ALL in 2012.

Table 1. Personal Income tax in Albania during 2005–2007

Monthly wage from (ALL)	to (ALL)	%
0	14000	+ 1% of the amount above 0
14000	+ 40000	140 + 5% of the amount above 14000
40000	+ 90000	1440+ 10% of the amount above 40000
90000	+ 200000	6440+ 15% of the amount above 90000
200000	+ And more	22940 + 20% of the amount above 200000

Source: *Albanian Tax Law*

⁷ Gerti Shijaku and Arlind Gjokuta, “Fiscal Policy and Economic Growth: The case of Albania,” *Working Paper*, no. 4(2013): 43.

In 2014, Albania adopted the progressive tax system for the taxes on personal income from employment with periodical amendments since December 2020 that is the last amendment in force. According to this system, upon the increase of tax base is also increased the tax rate. Three divisions are used for the calculation of personal income tax on wages and the rate of tax applied is different for each one. In Table 2, is shown the wage margin and tax rate in % for each division.

Table 2. Personal income from employment tax rate by division and calculation in Albania

Taxable income from employment _ monthly wage in ALL	Income tax
0 to 30,000	0%
30,001 to 150,000	13% of the gross amount over ALL 30,000
Above 150,000	ALL 15,600 plus 23% of the amount over ALL 150,000

Source: General Directorate of Taxation in Albania, 2021; Law 8438 dt.28.12.1998 (amended)

Actually, personal income tax in Albania is levied at a flat rate of 15% on gross income, excluding 8% on dividends and employment income which are progressively taxed at 0%, 13% and 23% as mentioned above. There are also exemptions from taxation of several categories such as scholarships, pensions, etc. and an exemption for self-employed with a turnover up to 8mln ALL.

As part of fiscal indicators of the state budget in Albania, Personal Income Tax revenues accounted for 9.4% of the total tax revenues in 2010, 9.2% in 2011 and approximately 9.8% during the last four years (2018–2021) as shown in Table 3.

Considering these figures, personal income tax relative to total tax revenues seems small in Albania but for developing countries and countries in transition where personal income is a very small part of revenue compared to developed countries, this is normal.

Table 3. Fiscal indicators regarding consolidated budget of 2018–2021

ITEMS	2018	In % to GDP	2019	In % to GDP	2020	In % to GDP	2021	In % to GDP
Personal Income Tax (PIT)	36,517	2.2%	46,124	2.7%	41,080	2.6%	41,000	2.4%
Total tax revenue (TTR)	419,333	25.7%	426,271	25.4%	408,045	25.8%	442,153	26.3%
PIT/TTR in %	8.7%		10.8%		10.07%		9.7%	

Source: Ministry of Finance, 2021

Tax policy role in macroeconomic management in Albania plays an important role, for this reason the government is engaged in considering a new economic stimulus package that might include possible increase of the threshold of taxable income. International practices of taxation have been usually used as a significant guidance for past reforms in Albania⁸.

5. Importance of tax management in a family budget

All changes of personal income tax law has an impact on family budget. All budgets have almost the same components: income (monthly or annual income from any reliable source), fixed expenses (necessary expenses for the cost of living, including loan, rent, insurance, phone bills, etc.), variable expenses (cc payments, maintenance of car or property, groceries, etc.), discretionary expenses (not necessary expenses such as for entertainment purposes, eating at a restaurant or coffee at a bar) and personal financial goals (left over for savings, pension funds, vacations, furniture). Personal or family monthly budget is created by combining these elements. Family budgets for a modest standard of living have seven components: housing, food, child care, transportation, healthcare, other necessities such as clothing and entertainment, and *taxes*.

⁸ Agim Binaj, Ilir Binaj and Irini Limaj, "Personal Income Tax Policy Analysis: Albania vs. United States," *Interntional Journal of Economics and Financial Issues*, no 3(1) (2013): 42–49.

Taxes management is important for two main reasons: First, taxes have a budget impact, reducing it in 15% or more⁹, if we refer to high rates or marginal rates of taxation on personal income and second, if we do not manage them effectively, the amount to be paid to the state will be higher than the obligation, this means less money for completing the aims and needs of an individual. For these reasons, it is important to have knowledge of the legislation and to take advantage of all the opportunities it offers us, in order to not pay more than required. While doing a financial plan for personal finances or family finances, everyone must be careful by evaluating every rule and law knowledge, in order not to conflict with fiscal legislation and to use all the advantages and opportunities it offers, for not paying more than required¹⁰.

Taxes have a significant effect on family incomes, so each family must be careful to manage the taxable income, by reducing it according to allowed deductible expenses. Families in general, do not have much information on law changes and amendments, but there exist a lot of legislative techniques to be adopted in order to avoid over taxation, which is a legal form of reducing the taxable basis. This needs a lot of knowledge of fiscal code and adopted rules on personal income taxation. Avoiding taxes, means a reduced tax payment to state budget and more available money to spend, to save or to invest¹¹ by families, in order to increase their standard of living. Considering the opportune cost or the marginal rate of taxation, families can use better their income. Every family budget is influenced by the income of a family, the size and the composition of the family, occupation of family members, family goals, socio-economic status of the family, intercity differences and rewarding employment. In many countries, in order to calculate the taxes to be paid, you have to take into consideration

⁹ Article no. 4 on “Income Sources”, of Law No. 8438 date 28 December 1998 on “Income Tax” in Albania, Official Journal of Albanian Republic, No. 154, as amended.

¹⁰ Arthur J. Keown, *Personal finance-turning money into wealth, Seventh edition* (Boston: Pearson, 2016), 101–120.

¹¹ Long term investment in pension funds, considering the time value of money, making a good profit in the long term, even the amount is limited to 200,000 ALL, according to Albanian Law No. 8438 dated 28 December 1998 on Income Tax (changed) and Albanian Law No. 10 197, dated 10.12.2009 on Voluntary Pension Funds.

the marital status of an individual, because taxation differs when you are single, you are married or you have a family, divorced with children to take care of, widow/ widower, aged, with health problems or limited liabilities, among which single persons pay higher taxes than all the other categories.

In Albania, an independent taxation system is applied, where the individual is the basic unit of taxation and is taxed on the basis of his or her income independently of marital status.

Every year INSTAT makes a survey for calculating the incomes and the standard of living in Albania. This statistical survey is carried out at the household level and gives an overview of the socio-economic situation of the Albanian households. The last publication of the survey for 2020 shows the situation in Albanian families. If we refer to the most recent official statistical data of INSTAT, in 2018, the average monthly consumption expenditures of a household composed of 3.7 persons on average are 75,935 ALL. The estimation of the monthly average consumption expenditure of the household, in 2018 is 3.5 percent higher than in 2017 while in 2019 are 82,235 ALL, which is 5,6% higher than in 2018¹². The growth of consumer prices in 2019 is 1.4% compared to 2018. In 2020, the average monthly consumption expenditures of a household composed of 3.6 persons on average are 83,475 ALL. The estimation of the monthly average consumption expenditure of the household, in 2020 is 1.5 percent higher than in 2019. The growth of the consumer prices recorded in 2020 compared to 2019 is 1.6 percent.

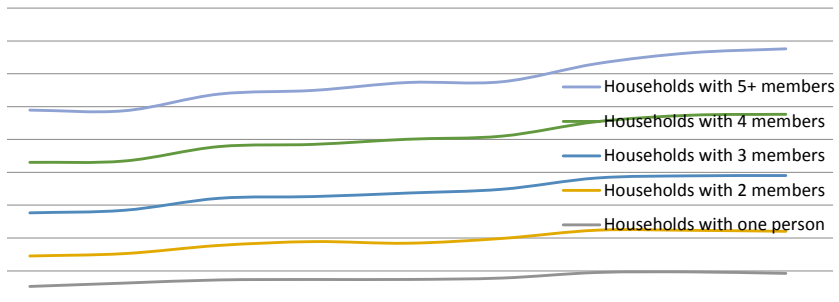


Figure 1. Monthly consumption expenditures, by household size INSTAT 2021

Source: INSTAT, 2021

¹² Albanian Institute of Statistics. "Household Budget Survey, 2020", INSTAT (2021): 1–11.

These figures show that monthly consumption expenditures have a positive trend over the years, which is partly connected to the inflation. Considering the trend of the monthly mean equivalised disposable income per capita in Albania during the same years, the figures show that these incomes positive growth makes less than 8% related to each previous year (Table 4), same as average middle wage trend during recent years (Table 5).

Table.4 Monthly mean equivalised disposable income

Monthly Mean equivalised disposable income per capita (ALL)			
2017	2018	2019	2020
24.526	26.144	27.849	30.169

Source: INSTAT, 2021(Income and Living Conditions Survey 2017, 2018, 2019, 2020)

Table 5: Average gross monthly wage per employee and approved minimum wage, 2018–2021(in ALL)

Description	IV/2018	2019	2020	2021
Average monthly wage per employee	52,312	52,376	53,787	57,182
Approved minimum wage	24,000	26,000	26,000	30,000

Source: INSTAT, 2021

Household structure of budget has more spending related to physiological needs, as food, clothing, etc. (Table 4).

Table 6: Household budget structure by the 12 main groups of consumption

Main groups	Viti / Year								
	2020	2019	2018**	2017	2016	2015	2014	2009	2007
Food and non-alcoholic beverages	41.6	41.3	44.7	44.1	45.2	48.7	44.3	49.4	47.6
Alcoholic beverages, tobacco	3.7	3.7	3.4	3.5	3.4	3.5	3.6	4.2	4.3
Clothing and footwear	4.6	5.2	4.2	4.3	4.8	4.9	5.1	5.4	6.2

Main groups	Viti / Year								
	2020	2019	2018**	2017	2016	2015	2014	2009	2007
Housing, water, electricity, gas and other fuels	10.0	10.1	10.3	10.9	10.2	10.3	10.2	9.0	7.4
Furnishing, household equipment and routine maintenance of the dwelling	6.9	6.7	6.3	4.8	5.0	4.8	5.4	4.9	5.9
Health	5.4	4.3	4.1	3.9	3.4	3.6	4.8	2.7	4.1
Transport	6.2	5.9	6.6	7.2	6.3	6.8	6.8	5.7	6.2
Communication	3.7	3.7	3.5	3.4	3.3	3.0	3.3	3.5	2.9
Recreation and culture	2.8	3.8	2.6	3.0	3.0	2.9	3.1	2.3	3.1
Education	3.1	3.1	3.0	3.9	4.4	2.1	4.2	2.0	1.7
Restaurants and hotels	5.6	4.9	4.6	5.0	4.4	3.6	3.2	5.0	5.0
Miscellaneous goods and services	6.3	7.3	6.7	6.1	6.5	5.8	6.0	5.8	5.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

* Household Budget Survey

** HBS 2018 data are revised due to methodological changes

As people have more basic needs, the living standards of people tend to rise if they live with other people. When they pool resources or share goods and services, the cost per individual of a given lifestyle is lower. But this is not true when couples have children, because they have additional cost for raising them. Expenses rise as family size increases.

Table 7: Household monthly consumption expenditures, by household type

Household Type	Viti / Year								
	2020	2019	2018**	2017	2016	2015	2014	2009	2007
One person	46,150	48,417	47,529	39,093	36,935	36,876	36,192	31,397	26,308
Adult with children	69,419	68,650	68,152	55,795	55,485	61,093	50,308	49,821	43,973
Two adults without children	63,965	63,255	64,419	60,329	55,025	57,909	52,938	44,844	46,456
Two adults with children	86,270	85,413	81,607	74,218	74,000	73,727	74,408	63,400	67,744

Household Type	Viti / Year								
	2020	2019	2018**	2017	2016	2015	2014	2009	2007
Three or more adults without children	92,108	90,309	84,818	81,829	84,376	75,819	76,570	78,054	77,411
Three or more adults with children	99,376	95,451	88,110	82,669	86,552	82,611	81,016	77,702	81,916

Source: INSTAT, 2021

Considering all we mentioned above, with the inflation, the low average monthly wage growth and the tendency of increasing expenses, along with the government policy for social welfare, there is a need for good management of taxable income of a family, as personal income taxes make up to 23% of monthly income and this has an impact in decreasing people's standard of living.

5. Conclusion

Determining the appropriate level of personal income taxation in Albania is one of the most difficult challenges the governments have dealt with for decades and this is confirmed by the continuous law amendments over the years. Still, there are a lot of debates related personal income tax rates being right. Considering the law in force, we can see that employment tax rates go to the highest level of income taxation, at a rate of 23% on payroll, while small business is taxed 0–5%, dividend is taxed at a rate of 8% and other business taxes do not exceed 15%. We can see that resources are not better distributed in terms of equality in general, but only among law and high wages employees. A flat tax system, compared with the progressive system, is not right as well. This system is not in favor of the individuals with low and medium personal income and favors individuals that earn higher wages. Since individuals with low and medium income make up for the majority of both public and private sector, then their contribution to the state budget revenues is greater. Progressiveness should be more moderate in order to avoid or minimize artificial changes and formal wage cuts. Those who respect the progressive payroll tax are mainly state-owned entities and large taxpayers such as banks, insurance companies, multinational companies, large manufacturing and commercial companies, while there are many other companies of small or medium size, which do not declare all employees

or the real level of wages, working in informality. The government should review the tax rate as the personal income tax on employees is much higher than the business tax rate. The government must consider the change of tax burden from the point of view of the most affected people, because a low burden can be accompanied with a decrease of motivation of people to work for more money or to save more money, as the taxes to pay grow. The fair distribution of tax burden must be central to taxation policy and the solution is the finding of an optimal tax system to have social welfare for the citizens on one hand and to fight demoralization on the other hand. The more taxes an employee pays, the lower the disposable income to cover the expenses. This creates a negative impact in the standard of living and the economic growth as a consequence.

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