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Digitalization of Business – Implications on Tax Evasion Dimensions

Abstract

Digitalization and technological advancements have changed how taxes are reported, controlled, and audited globally, as well as the speed, quality, and accuracy of the data used in those procedures. The prospects of digitization have been recognized by tax authorities, accountants, policymakers, regulators, and taxpayers, who have begun to reap the advantages of e-services, software, applications, websites, etc. This study explores the impact of business digitization on many facets of tax evasion. The amount of digitalization adoption is gauged using the World Bank's digitalization adoption index, and tax evasion is represented by the shadow economy. The study is based on a vast dataset that contains information from 155 nations. A regression model was employed to assess the relationship between digital adoption and tax evasion. The analysis shows that inflation, unemployment and economic freedom did not have a significant effect on tax evasion. The findings on the show a negative and significant relationship between business adoption of digitalization and tax evasion, suggesting that digitalization aids in lowering tax evasion. The results may help authorities see digitization as a powerful tool for preventing financial crimes. Investment in technology may increase tax collections and help governments allocate resources more effectively. To increase the effectiveness of tax collection and monitoring, governments should focus on accelerating the digitization process, particularly in emerging nations. The advantages of investing in digitization will outweigh the expenditures, even though it may result in higher startup costs for emerging economies.

Digitalization of Business – Implications on Tax Evasion Dimensions

Introduction

Business digitization or digital transformation occurs when a firm integrates digital technologies or information technologies into diverse aspects of its operations, business processes, and strategies. Such digitization enables a firm to enhance its efficiencies in various domains, bolstering customer experiences, gaining competitive advantage, and creating better growth opportunities (Advani, 2021). In addition, quick advances are occurring in information technologies like the internet of things, machine learning, artificial intelligence, and big data with implications on tax evasion (Ruan et al., 2018). As a result, business digitalization is increasingly essential to adapt business enterprises to the rapidly modernizing operational spaces and markets.

While digitalization has benefits, these co-occur with implications, with tax evasion being one of the major concerns. Businesses could evade tax through non-payment and underpayment strategies where they fail to remit the appropriate tax amounts to the corresponding taxation authority or body (Khyareh, 2021). Business digitization increases the techniques by which firms and individuals may evade taxes because it increases avenues for anonymizing transactions and rapidly moving funds to create enough time for cover-ups (Kitsios et al. 2022). Furthermore, it provides opportunities to create a complicated financial structure where firms wire and move gains or valuable assets to offshore accounts, tax havens, and anonymous accounts (Kutera, 2022; Khyareh, 2021). Multinational businesses are the most notable players in such schemes because they increasingly rely on digital financial systems and payment gateways.

There has also been an increasing ubiquity of digital systems in financial technology as governments and multinational corporations embrace them. Such systems also evolve rapidly, and many different versions and applications emerge in the fintech industry (Advani, 2021). When the financial industry experiences major disruptions from a technological shift or how technology is used, including massive security breaches or fraudulent financial architectures, there are substantial losses in trackable tax revenue. For example, significant frauds and security breaches in cryptocurrency, NFTs, and businesses that deal in digital tokens have often resulted in the disappearance of taxable funds (Kutera, 2022). In addition, tax evaders have more access to sophisticated tools that use big data, machine learning, and predictive analytics, which serve to protect assets or determine transaction activities that could help avoid financial tracking by authorities. As such, the tax evasion problem is exacerbating as the intending offenders get more tools, skills, and mechanisms for navigating a monitored financial environment.

Exploring the tax evasion issues that come with business digitization is crucial as it could reveal the possible ways for mitigating such evasion. Both public and private entities could benefit from a more trusted taxation environment where most taxpayers meet their obligations (Apostu et al., 2022). Tax revenue is vital for infrastructural development and economic performance (Obreja, 2022). A sound state of infrastructure supports business operations, and a high-performing economy is also helpful in sustaining

high business performance.

The New Trends of Business Digitization

Big Data is becoming integral to digitizing large firms and data-intensive businesses. Such data is easy to amass with current technologies, including location and identity-tracking technologies, machine learning and deep learning systems like neural networks, and social media. The popularity of Big Data in fintech has increased due to the need that firms have for quick and robust decision-making, which bad actors also leverage in tax evasion (Ruan et al., 2018). The fintech industry is data-intensive, and the vast data is multi-dimensional and multi-faceted. For example, tracking the value of cryptocurrencies is relevant to firms that receive payments, deposits, or other transactions in digital currencies. Furthermore, the performance of digital currencies also influences the market performance of particular firms with valuable clients involved in financial technology. Video game companies and luxury traders are some such businesses (Faccia et al., 2020). Therefore, the incentive to collect and utilize Big Data is high in the era of the rapid spread of fintech.

Artificial intelligence is the other major trend driving business digitization. Firms realize the value of such intelligence in products, operations, logistics, marketing, sales, and management efficiency. Carvalho et al. (2020) describes how some firms digitize due to product digitization through artificial intelligence. In such cases, some firms create or adopt a product requiring more digital engagement with customers, e.g., after developing an app to offer services to clients or technical products that automate maintenance and support that a firm offers its clients. Such products lead to creating digital platforms or digitizing business units, departments, or roles (Kessel & Graf-Vlachy, 2022). Artificial intelligence makes automating more roles, interactions, and transactions possible. Such intelligence also improves a firm's capability for generating more revenue by upscaling its operations.

The internet of things (IoT) provides another major digitalization trend for businesses. IoT interconnects various physical devices to enable the coordination and collection of information and data on devices and their usage, processing such data and its analysis on a potentially vast scale (Kumar et al., 2022). The devices are often tied to users or particularly valuable functions, e.g., consumers' smartphones that hold user data and facilitate transactions, intelligent household devices for households, and industrial tools or equipment. Firms and entrepreneurs leverage IoT to upscale their operations, improve business intelligence, enhance efficiency, and increase productivity. For example, coordinating interconnected devices with real-time operational and performance data provides more technological resources to secure, utilize, or manipulate financial operations (Nistor & Zadobrischi, 2022). Firms could utilize such systems to misrepresent or conceal the fundamental nature of their operations and earnings.

Tax Evasion

Tax evasion is a perpetual problem that is increasingly complex in the digital era. Various entities and individuals evade tax for different motives, including the desire to amass wealth or avoid income deductions, sheer corruption, amoral norms or amoral business culture and practices, and the pressure of economic or financial conditions (Khyareh, 2019). However, Di Gioacchino and Fichera (2020) identified tax morale as a typical driver of tax evasion tendencies. Tax morale is an entity, individual, or party's willingness to comply with a tax code and remit the taxable funds to a responsible authority. Di Gioacchino and Fichera (2020) demonstrated that such morale is strong among people who find the tax code and system meaningful and valuable, reducing their likelihood of evading tax. The authors also demonstrated the influence of social ties as people were likely to elicit tax compliance behavior similar to those in close social circles.

Corruption is an overarching theme in literature exploring tax evasion as it explains the behaviors leading to tax evasion. For example, Amoh and Ali-Nakyea (2019) analyzed tax evasion in the context of corruption within an emerging economy. There was substantial evidence of corrupt behavior and systems that facilitated tax evasion. However, the effect of corruption was also secondary, as people that believed their authorities or governance systems were corrupt also tended to avoid paying taxes.

Tax evasion also links to economic conditions as tough conditions drive people towards avoiding deductions on their earnings and assets. A poorly-performing economy does not support most people's efforts to make money, while a strong economy boosts entrepreneurship, improving people's access to valuable money. Khyareh (2019) analyzed how tax evasion, entrepreneurship, and corruption correlated in various OECD countries and showed that conditions of low entrepreneurship correlated strongly with more tax evasion. Similarly, high levels of entrepreneurship correlated with a reduced propensity to avoid paying taxes.

Tax evasion and business digitization relate as the latter provides more mechanisms to either avoid taxes or manage and track transactions and activities related to taxation. Kitsios et al. (2022) demonstrated that digitalization influences tax evasion in cross-border fraud as it increases the difficulty of evading taxes when authorities deploy better technologies. Therefore, there is the potential for digitalization to increase accountability and transparency to help governments prevent or detect tax evasion.

Tax Evasion Costs

The cost of tax evasion is immensely critical to examining its implications on stakeholders in business, including governments, investors, entrepreneurs, employees, and the broader community. Tax evasion causes significant revenue losses for governments as they depend on tax remittances to supply public services and goods like education, infrastructure and healthcare (Adam, 2020). The loss of tax revenue due to tax evasion leads to underfunding of the public sector, affecting a nation's or territory's

living standards. Agostino et al. (2022) also noted that there are also systemic costs of tax evasion, like its abrogation of the law, motivating lawlessness, and causing distrust in public institutions.

The other systemic cost of tax evasion occurs through the inequality it creates when tax revenues cannot suffice basic welfare services and essential infrastructure. Alm (2021) noted that the poor depend most on essential infrastructure, welfare, and critical public services because they cannot afford private alternatives. Similarly, wealthy people have access to the technologies, expertise, and resources that could help avoid or reduce taxes. Therefore, a culture of tax evasion favors the rich, shifting the financing burden for public services and goods to low-income businesses and workers (Amoh & Ali-Nakyea, 2019). The result is an increase in income and wealth gaps.

For businesses, tax evasion costs firms their reputation and exposes them to legal costs and restrictions. Brenner and Hartl (2021) demonstrated that businesses with a taint of tax evasion must deal with multiple consequences, including penalties, fines, criminal charges, and sanctions. Firms also lose partnerships and may be unable to retain investors, employees, or customers. Entrepreneurship also declines in an environment of tax evasion as businesses need access to supportive infrastructure and public services (Khyareh, 2019). Such costs reverberate through effects on communities needing business services to develop.

The Impacts of Big Data and the Internet of Things (IoT)

Big data and IoTs are significant technological advances transforming business strategies and financial intelligence for both good and bad actors. Big data is voluminous data with numerous properties that make it possible to make reasonably accurate predictions or deductions in the real world (Skare & Soriano, 2021). The data comes from collecting signals, information, patterns or trends from sensors, transactions, social media, and people's interaction with targeted contexts, devices, places, or products. IoT is the collection of devices, digitized systems, or tools interconnected by the internet (Adam, 2020). The internet makes it possible for most digitized devices to communicate in meaningful contexts, which creates such systems as IoTs.

Big data and IoTs influence tax evasion by providing versatile, quick, large-scale systems and platforms for collecting, processing, and sharing transactional data, intelligence, and transferring value. On the one hand, governments can harness big data and analyze it to track anomalies in tax compliance, thereby curbing tax evasion (Pérez López et al., 2019). On the other hand, bad actors could similarly leverage the technology to sophisticate their tax evasion. IoT could also help authorities track financial transactions and asset movement by having updated information on devices near these transactions (Kitsios et al., 2022). Tax evaders can also leverage IoTs to coordinate tax fraud by building intelligence on government activities and weaknesses in various areas.

Conclusion/Summary

The review reveals that business digitalization creates avenues for tax evasion but also improves the robustness of tax compliance systems that leverage digital technologies to track transactions and analyze business activities. Firms benefit immensely from business digitization through operational efficiencies, lower costs, and opportunities for entrepreneurial growth. However, bad actors also leverage digitization for tax evasion by applying digital technologies to hide assets, complicate transactions, and create anonymity. The trend causes significant tax revenue losses, which disadvantage small businesses and the poor that bear the tax burden. Firms can avoid the effects of tax evasion by increasing their compliance.

Governments could prevent tax evasion in the era of business digitization by nurturing positive tax morale and applying advanced technologies to seal loopholes in tax systems. Authorities may also run counterintelligence against entities that leverage the technologies for tax evasion. Such effort would require the integration of efforts by experts in financial technology, law enforcement, forensics, innovators in the technological space, and the members of society. Business digitization could continue with benefits to firms through big data, IoT, other data and networking technologies, and analytics while also helping detect and mitigate tax evasion.

Objective of the Study

This study aims to determine the effect of digitalization of business on tax evasion dimensions. Adoption of digital technologies—including the internet, mobile phones, and all other instruments utilized in the economy—is referred to as digitalization in this study and is gauged using the World Bank's Digital Adoption Index (DAI).

Hypothesis

As a result, we created the following hypothesis to determine whether or not digitization is a useful tool to discourage tax evasion;

H0: Digitalization of business does not have a significant effect on tax evasion dimensions

H1: Digitalization of business does not have a significant effect on tax evasion dimensions

Methodology

Research design

Sample

Over 155 nations across the world are examined for the digitalization adoption index (DAI). For the purpose of measuring tax evasion (TE), the shadow economy (Multiple Indicators Multiple Causes, or MIMIC) is employed in over 155 different nations. A sample of 155 nations has been produced after the removal of all missing data. Some nations have also been eliminated after testing the outliers. As a result,

155 nations were included in our sample. Regarding geography, financial level, and cultural variance, the sample includes a wide range of nations.

Models used in the Study

To test the hypothesis, a regression model was used with tax evasion as the dependent variable and the major independent variable being the digitalization adoption index. In addition to these, the model incorporates control variables for economic freedom, inflation, and unemployment.

Table 1: Variables Definition

Variables	Definition	ABBRE
Dependent variable		
Tax Evasion	Estimates of informal output based on the Multiple Indicators Multiple Causes (MIMIC) model	TE
Independent variables:		
Digitalization Adoption index	The DAI is a global index that evaluates how well a nation has embraced digital technology in three areas of the economy: people, government, and industry. The index stresses the "supply-side" of digital adoption to increase coverage and make theoretical links more straightforward. It is based on a 0–1 scale and includes 180 nations. The simple average of the three sub-indices determines the overall DAI. Each sub-index includes the technologies required for the corresponding agent to promote development in the digital era, including those that boost business productivity and broad-based growth, increase opportunities for people and welfare, and boost government service delivery accountability and efficiency.	DIA
Control variables		
Inflation	The consumer price index, which measures inflation, tracks the annual percentage change in the typical consumer's cost of obtaining a basket of goods and services that may be set or modified at predetermined intervals, such as annually.	Inflation
Unemployment	The percentage of the labor force that is unemployed yet looking for work is referred to as unemployment.	

Economic freedom	Limited Government, Regulatory Efficiency, Rule of Law, and Open Markets are the four main categories that the overall index of economic freedom is divided into. The degree of economic freedom is measured on a scale from 0 to 100, with 100 being the greatest degree of freedom.	
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Dependent variable

As a proxy for tax evasion, the study employed the shadow economy index. Although there are direct and indirect ways to quantify the shadow economy, we opt to utilize estimates of informal output based on the Multiple Indicators Multiple Causes (MIMIC) model. (Elgin et al., 2021)

Independent variables

To gauge the level of digitization, the study utilized the World Bank's Digital Adoption Index (DAI). This index, which measures the dimensions of economies in terms of people, government, and business, spans 155 nations. It is a composite of three sub-indices. The applicable sub-index is the Digitalization Adoption by Business (DAIB), which analyzes the indicators relating to business websites, download speed, secure servers, and network coverage and focuses on fostering productivity and growth for businesses.

Results and discussions

Descriptive statistics

Table 2. Descriptive statistics for dependent and independent variables

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
TE	155	8.00	63.00	28.606	11.063
Digital Adoption Index	155	.14	.87	.500	.191
DAI Business Sub-index	155	.14	.94	.553	.199
DAI People Sub-index	155	.01	.88	.409	.236
Inflation	155	-1.54	32.35	4.125	5.399
Unemployment	155	.14	27.04	7.318	5.537
Econ_Freedom	150	25.00	84.00	60.827	10.945

The mean for the proxy of tax evasion measurement is 28.61(SD=11.06). The mean for overall Digital Adoption Index is 0.5(SD=0.191), the mean for Digital Adoption Index for business is 0.553(SD=0.199), the mean for DAI People Sub-index is 0.409(SD=0.236), the mean inflation is 4.125 (SD=5.40), the mean unemployment index is 7.32 (SD=5.54), while the mean for economic freedom is 60.83(SD=10.95).

Correlation matrix

Table 3: Correlation matrix

Correlations

	TE	Digital Adoption Index	DAI Business Sub-index	DAI People Sub-index	Inflation	Unemployment	Econ_ Freedom
TE	1						
Digital Adoption Index	-0.54**	1					
DAI Business Sub-index	-0.519**	0.936**	1				
DAI People Sub-index	-0.579**	0.958**	0.920**	1			
Inflation	0.208**	-0.283**	-0.332**	-0.313**	1		
Unemployment	0.060	-0.006	0.040	-0.002	0.053	1	
Econ_Freedom	-0.479**	0.745**	0.754**	0.740**	-0.367**	-0.072	1

Table 3 shows a correlation matrix that shows there is a statistically significant negative strong correlation between tax evasion (proxy for tax evasion) and digital adoption index. There is a moderately strong negative correlation between economic freedom and tax evasion, $r=-0.479$, $p<0.05$. The analysis shows that there is no significant relationship between unemployment and tax evasion, $r=0.060$, $p>0.05$.

Regression analysis

Table 4: Coefficients of Regression-Model 1

Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients		Collinearity		Statistics
	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
(Constant)	42.447	5.702		7.444	.000		
Digital Adoption Index	2.358	15.731	.040	.150	.881	.061	16.386
DAI Business Sub-index	2.350	11.477	.042	.205	.838	.105	9.510
DAI People Sub-index	-29.029	11.194	-.620	-2.593	.010	.078	12.898
Inflation	.007	.149	.004	.050	.960	.833	1.201
Unemployment	.062	.139	.030	.449	.654	.964	1.037
Econ_Freedom	-.079	.107	-.078	.449	.463	.397	2.517

a. Dependent Variable: TE

Table 4 shows coefficients of regression for model 1. The R-squared for regression model 1, 0.366, suggests that the independent variables explain 36.6% of the total variation in tax evasion. The F-statistic, $F(6,143) = 13.74$, $p < 0.05$, suggests that the regression model is a good fit for the data. The analysis shows that only Digital Adoption Index People Sub-index has statistically significant negative relationship with tax evasion (-29.029), $p < 0.05$. Digital Adoption Index and Digital Adoption Index Business Sub-index do not have a significant effect. The Value Inflation Factors for Digital Adoption Index People Sub-index and Digital Adoption Index are very high implying that they will be dropped from the model because they will cause multicollinearity problems. Inflation, unemployment and economic freedom did not have a significant effect on tax evasion.

Table 5: Coefficients of Regression-Model 2

Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Collinearity		Statistics
	B	Std. Error	Beta		Sig.	Tolerance	VIF
(Constant)	50.411	5.263		9.577	.000		
DAI Business Sub-index	-24.929	5.957	-.446	-4.185	.000	.416	2.401
Inflation	.006	.152	.003	.042	.967	.848	1.179
Unemployment	.081	.143	.040	.568	.571	.970	1.031
Econ_Freedom	-.140	.109	-.138	-1.291	.199	.411	2.430

a. Dependent Variable: TE

Table 4 shows coefficients of regression for model 1. The R-squared for regression model 1, 0.314, suggests that the independent variables explain 31.4% of the total variation in tax evasion. The F-statistic, $F(4,145) = 16.57$, $p < 0.05$, suggests that the regression model is a good fit for the data. The analysis shows that only Digital Adoption Index business Sub-index has statistically significant negative relationship with tax evasion (-24.929), $p < 0.05$. Inflation, unemployment and economic freedom did not have a significant effect on tax evasion. This is in line with Knudsen's (2020) findings, according to which technical advancements have been made since conventional accounting techniques were replaced by information technology and accounting software. Knudsen (2020) examined the impact of digitalization on accounting practice from a variety of angles, including how it affects the limits of accounting, how it alters power dynamics, and how it affects the generation of information for decision-making. The effect of digitization on the growth of the accounting profession was examined by Gulinet al. in 2019. They said that accounting data quality, speed, and accuracy have all improved with the digitization of accounting and financial reporting. Alm (2021) examined the impact of digitization on tax evasion and made the case that the advancement of technology will boost the flow of information to governments, improving their capacity to reduce tax evasion. But he also mentioned that with technological advancement, some people or businesses can discover new ways to cheat or avoid taxes.

Conclusion

This research aims to investigate how digitization has affected tax avoidance. This study demonstrates that the adoption of digitalization has a major influence on discouraging tax evasion behavior. We utilized an international sample of 155 nations to test our assumptions. Because it emphasizes how crucial digitization is to lowering tax evasion behavior, this research has policy implications. To increase the effectiveness of tax collection and monitoring, governments should focus on accelerating the digitization process, particularly in emerging nations. The advantages of investing in digitization will outweigh the expenditures, even though it may result in higher startup costs for emerging economies. The difference between actual tax revenues and estimates should be closed by the government. To appropriately project tax revenues in the budget, the government must first assess the extent of corruption in the nation. Additionally, the sort of digitization that the government prioritizes is essential for lowering tax avoidance. According to this survey, people's acceptance of digitization has a greater overall impact on tax evasion than the other categories. Therefore, each government should assess which form of digitization will have the most impact on lowering tax evasion there.

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