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VAT, A TAX WITH GREAT IMPACT ON STATE REVENUES IN ALBANIA

Abstract:

In an economy in transition that is moving toward a market economy, a question is raised: Will the tax policy reflect the changes? The answer of this question lies in an issue of vital importance for the future of the country that is the attraction of foreign investments, in a time when tax competition is increasing in the regional and global level. The development and prosperity of a country is closely related to the increasing number of investments and economic activities, and besides economic formulas should be taken in consideration also the importance of sensitivity of all collection and contributing tax structures. In this context, we don't have to forget the very important issue of having not only a modern tax policy but also a modern tax administration. In the modern world the key to success is communication between politics and business, directly and indirectly, as a quite diplomatic process. In theoretical analysis of tax policy one of the requirements that is strongly supported by the IMF is the sustainability of the tax system which means no changes in tax laws. Tax sustainability is affected by the legal framework in order that tax administration consistently applies the tax legislation and its regulations. It should publish information on how to interpret and implement this legislation.

Keywords:

tax system, tax policy, fiscal indicators, state revenues, value added tax

JEL Classification: A10

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1. Introduction

The global financial crisis exerted significant pressure on the Albanian economy. As a result of the global crisis, growth rates were decreased significantly. Real growth in 2009, was dimidiated compared to its historical trend, but remained positive (3.3 percent of GDP), as a result of limited financial exposure to international markets and an expansionary fiscal policy initiated before the crisis. With particularly strong economic and trade relations to Italy and Greece, the crisis in these countries was reflected in the Albanian economy by decrease of remittances and exports, which led to a significant slowdown of economic growth and particularly of budget revenues.

The economy had a moderate rate of growth of 3.8 percent in 2010 and 3.1 in 2011. In 2012 and 2013, the economic growth has further decreased. The rate of economic growth fell to 1.3% in 2012 and continued to decrease significantly during 2013. During the first nine months of 2013 Institute of Statistic in Albania estimated that the economic growth was 0.4% lower compared to the same period a year ago. Domestic demand remains very weak and in all probability private investments will not increase. Foreign demand has been the main generator of growth in the past two years; however, it remains constrained by unfavorable developments in the economies of the eurozone and non-diversified base of exporters, both in terms of products, as well as markets. Over the years the government has undertaken fiscal measures to facilitate the business environment, in order to fulfill its obligations to the country and society, and to make it attractive to private and foreign investments, and to increase exports. The main fiscal indicators will support the macroeconomic stability and its growth in the coming years. As shown in the following table, revenues and expenses to GDP and budget deficit increased. The increase of the overall budget deficit is result of increased foreign investments, which are entirely investments in infrastructure and other priority sectors, while domestic deficit will decrease as a result of lower rate growth of expenses with internal resources to budget revenues.

Table 1.1 Main Fiscal Indicators of GDP in %.

ITEMS	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
TOTAL INCOMES	25.1	26.0	26.0	26.7	26.0	26.6	25.8	24.9	24.2	23.5
TOTAL EXPENSES	28.5	29.3	29.5	32.3	33.1	29.7	29.3	28.4	29.0	26.5
DEFICIT	-3.5	-3.3	-3.5	-5.5	-7.0	-3.1	-3.6	-3.5	-4.8	-3

Source: Ministry of finance

The ratio of tax revenue to gross domestic product in Albania is lower than most countries in the region and far from average tax ratio / GDP of countries that joined the EU. Based on predictions of demand and aggregate supply, one of the main scenarios presented by the Ministry of Finance predicts a real GDP growth of 3.3% in 2015 and 4.2% in 2016. Fiscal policy for the period 2014 - 2016 will be oriented toward a fiscal consolidation. Primarily it aims to direct public finances toward a sustainable trajectory, as one of the main pillars of economic growth and sustainable development of the country. The main goal of midterm fiscal policy is to recover country's economic growth at its potential levels and sustainability over the time.

2. OBJECTIVES

i. to indicate the VAT contribution on state revenues
ii. to compare the VAT level of Albania with that of regional countries and EU countries

3. RESULTS AND DISCUSSIONS

The VAT system in Albanian fiscal legislation (based on considerations of internationals) is considered as well designed: it is simple, has a broad base, contains only a fee level of 20% and has a reasonable exception limit, typical to developing countries, in order to facilitate the administration of this tax. It is estimated that this tax is among the most consolidated taxes in our fiscal system.

Value Added Tax is one of the most problematic items for the moment with decreased revenues
-7.3 percent on annual basis, being at the level of 99.3 billion ALL, almost to the level of the year 2009.

Table 2. Revenue performance by items for 11 months during 2009-2014 (in million ALL)

ITEM	11M-09	11M-10	11M-11	11M-12	11M-13	11 M-14
TOTAL REVENUE	**268,031**	**293,27**	**295,67**	**301,55**	**292,16**	**329,145**
I. Incomes from Grants	**2,517**	**2,777**	**2,601**	**4,805**	**4,303**	**8,625**
II. Tax. Revenue	**245,962**	**261,137**	**272,394**	**274,966**	**267,644**	**301,439**
II.I From Taxes and Customs	**189,742**	**201,486**	**210,103**	**212,152**	**202,637**	**230,832**
1. Value Added Tax	99,893	103,242	106,63	107,141	99,335	113,751
2. Profit tax	15,797	15,925	18,043	15,183	13,561	19,289
3. Excise tax.(Luxury item tax)	30,538	34,833	36,014	33,133	33,167	37,932
4. Personal Income Tax	24,222	24,211	24,800	24,993	26,008	24,794
5. National taxes and others	12,184	16,830	18,406	26,155	25,497	29,725
6. Customs duties	7,107	6,445	6,209	5,547	5,069	5,341
II.2 Revenues from Local	**11,106**	**10,621**	**10,776**	**10,103**	**10,091**	**11,564**
1. Property tax.	1,398	1,795	1,767	2,393	2,286	3,296
2. Small business tax	2,349	2,256	2,500	2,054	1,914	1,661
3. Local tax	7,359	6,570	6,509	5,656	5,891	6,607
II.3 Incomes from special	**45,114**	**49,030**	**51,515**	**52,711**	**54,916**	**59,043**
1. Social Insurance	40,021	41,170	44,311	45,168	46,660	51,051
2. Health Insurance	5,092	5,933	5,741	6,372	6,694	7,746
3. Revenue for property		1,927	1,463	1,171	1,562	246
III. Non tax revenue	**19,552**	**29,363**	**20,682**	**21,780**	**20,219**	**19,081**
1. Profit transfer from Bank of	3,741	4,486	5,410	4,193	4,508	1,951
2. Incomes of budgetary	8,652	12,937	9,494	9,111	9,414	10,327
3. Dividend	3,468	578	836	426	928	1,380
4. Tariffs on Service	*3,692*	*2,749*	*3,134*	*3,430*	*2,920*	*2,858*
5. Others		8,613	1,808	4,620	2,449	2,564

Source: Ministry of Finance

The current VAT rate is almost as much as the average of Central and Eastern European countries, but higher than in neighboring countries such as Macedonia, Romania, Montenegro, Kosovo, and Greece.

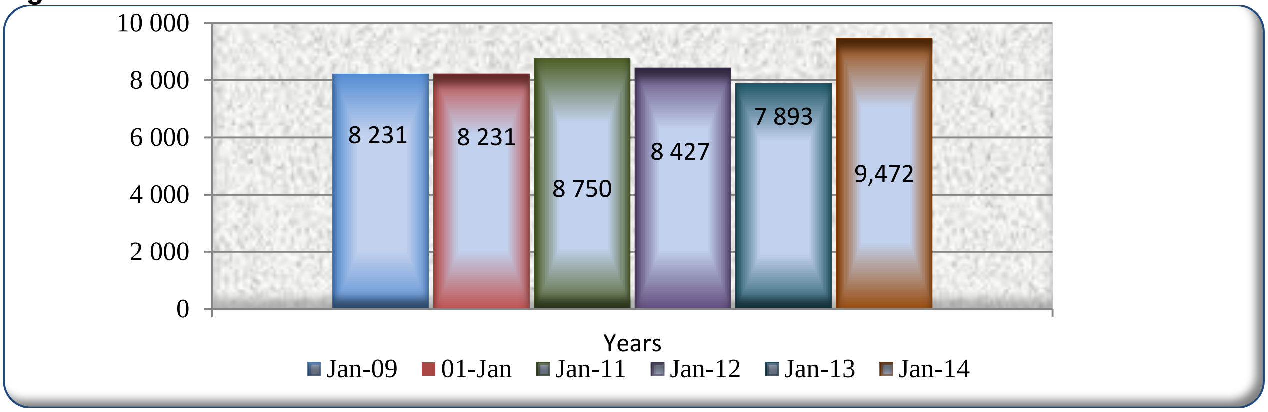
Table 3. VAT in the countries of the Region (the level of the fee in percentage)

Croatia	**22.0**
Bulgaria	**20.0**
Albania	**20.0**
Slovenia	**20.0 / 8.5**
Macedonia	**19.0 / 5.0**
Greece	**19.0 / 8.0**
Romania	**19.0 / 9.0**

Source: IMF

Based on the importance that this tax have in the state budget (48% of total revenue from the tax and customs administrations), VAT is considered to be the most important tax of the Albanian fiscal system.

Figure 1. VAT in million ALL



Source: Ministry of Finance

Recently in our country, economists and accountants propose that the application of the escalating VAT system will improve its regressive nature, in terms of VAT for personal incomes per capita. If two or more tax rates are applied, we would have to deal with the standard rate which is actually on all goods and services and with the reduced one which is proposed. Reduced tax rate is required only to widespread consumer goods as for e.g.: foods (except alcoholic beverages), fuel for certain business segments and for the population power, heating, drinking water, and public transport. Theoretically, the application of the reduced rate for these goods and services does not influence the fiscal neutrality, as these goods and services do not compete with others and the demand for them is not elastic. Revenues from taxes and custom duties constitute the main item in providing revenues for the State Budget. Over the years it is noted that there is an increase in incomes, which generally reflects the improved management of public finances, the system of collecting revenues and business climate. However, the main provider of tax revenue continues to be Value Added Tax (VAT) with about 50%, Excise tax (luxury item tax) in second place, while Personal Income Tax (PIT) and Profit Tax have been taken each other place over the years.

Table 4. Revenue tax from* General Directorate of Taxes *and* General Directorate of Customs *in million ALL

REVENUE TAX FROM GDT and GDC (MONTH)											
YEAR 2014	**Jan**	**Feb**	**Mar**	**April**	**May**	**Jun**	**July**	**Aug**	**Sept**	**Oct**	**No**
Value Added Tax	9,472	19,155	30,197	40,594	50,361	61,177	70,693	81,599	91,908	103,425	113,75
Profit Tax	1,007	2,363	6,332	7,950	9,477	11,167	12,587	13,924	16,109	17,634	19,28
Excise Tax	1,616	3,660	6,110	9,083	12,500	16,274	19,923	24,850	29,297	34,137	37,93
Personal Income Tax	2,569	4,576	6,444	8,716	10,903	13,160	16,242	18,261	20,476	22,674	24,79
National taxes and others	2,482	4,806	7,494	9,842	12,869	15,802	18,582	21,722	24,587	27,131	29,72
Customs duties	388	789	1,241	1,707	2,255	2,755	3,255	3,741	4,249	4,833	5,34
Total	**17,534**	**35,349**	**57,818**	**77,892**	**98,365**	**120,335**	**141,282**	**164,097**	**186,626**	**209,834**	**230,83**

Source: Ministry of Finance

4. Comparisons to regional countries and European countries

Tax systems and fiscal advantages are used more and more as instruments of competition. Often in public debates, to justify the decisions on the increase of taxes and fees, financial authorities of the country have been defended by promoting that tax levels are in fact among the lowest in the Region. An investor, who intends to serve at the Balkan market, would consider for his potential investment one of the countries that is analyzed. In the SWOT analysis that he would perform, the cost factors, mainly those of tax systems, would play the major role on investment decision. As a result, differences in fiscal investment systems become instruments of regional competition. Comparative analysis of the fiscal system has encountered difficulties in finding information on relevant legislation. In general, there is no transparency of fiscal systems in the countries of the Region. This complicates the analysis, and at the same time has its impact on the degree of competitive positions and uniformity of analysis.

What are the factors that influence the decision-making process of a project?
There are identified factors that affect the decision making process of an investment, our country has an unfavorable position. Key factors are political situation, infrastructure and cost factors. It is not necessary to make comments on the first two factors, even in the terms of cost factors (such as prices of energy and other inputs, costs of labor, etc.), our country does not appear to enjoy advantages.

The following analysis distinguishes two moments in the investment process: ***fiscal burden*** in the increased project costs before it becomes operational (that is, before an enterprise can begin to function and make profits) and ***the impact of the fiscal burden on the profitability*** of a project (associated with the investment payback period). On the basis of this analysis, we have elaborated a review of our country's competitive position.

- **Albania**

• *Costs before an investment*

In their business plans, apart from costs related to the acquisition of technology, investors should also add charges that should be paid immediately to custom that is: customs duties (for machinery and equipment and other capital goods) at least 5 percent (as many categories of goods, which are mainly raw materials, have tariffs that reach up to 10 percent); VAT at 20 per cent, on the amount of the purchase invoice (purchase price + transport costs + cost for insurance) plus customs duty. Cumulative costs on the fiscal burden increase at least by 26 percent.

• *Profitability of investment and investiture costs*

Profits, realized by economic entities are taxed 15 percent. While, dividends, interests and other types of profits, with economic activity source within the country, pay a withholding tax of 10 percent for residents and 15 percent for non-residents. Labour costs are increased with about 42 percent for cash payments to social security and health insurance.

- **Macedonia**

• *Costs before an investment*

Foreign enterprises wishing to operate in Macedonia (for a period of at least five years), are excluded from customs duties on machineries and equipments (capital goods) that are part of the investment project.

The basic level of sales tax (VAT) is 25 percent, while the level of this tax, which is applied on imports of capital goods, agricultural machinery, as well as basic food products, is 5 percent.

• *Profitability of investment and investiture costs*

The basic level of income tax is 15 percent (while tax to services is 13 percent). Foreign companies have an exception from this obligation for the first three years of their operation. In the case of reinvestment of profits the company is excluded from the income tax. Return of profits to the country of origin (from Macedonia to the investitures country of origin) is subject to a tax of 10 percent. *Withholding* tax applies at the rate of 23 percent (on bank interest, capital profits, dividends, etc.).

Investor's payments for employment are:

- contribution to the employment fund is 1.5 percent;
- contribution for health insurance is 8.6 percent;
- contribution to pensions is 20 percent
- *total: 30.1 percent*

- **Bulgaria**

• *Costs before an investment.*

VAT is applied at the rate of 20 percent. Foreign companies enjoy the following advantages:

- machineries and equipment, technologies, patents, industrial models, the right to trade, know-how, etc.,
- are excluded from customs duties and VAT, only if the investment is over 100 thousand dollars and last for more than 5 years.

• *Profitability of investment and investitures costs*

The level of income tax on economic activities is 40 percent (and 30 percent for companies with an annual profit of up to 1 million) and 50 percent for banks.
Withholding tax is 10 percent (paying dividends for joint ventures or foreign companies) and 15 percent (for interest, royalties, other payments, etc.).
Payment of social insurance is in total 35 percent (while for foreign citizens employed by the company 20 percent).

Fiscal facilities offered:
The company is excluded from income tax for the first three years and has 50 percent of discount for three other years. This facility is offered based on certain conditions (such as the size of the capital should be over 5 million dollars and 50 percent should be foreign participation, employment of disabled or rehabilitated, etc.).

➢ **Romania**

• *Costs before an investment.*

Based on the current legislation, foreign investors benefit from these facilities: machineries and equipment, vehicles, know-how and other goods that are subject to amortization are *excluded from customs duty and Value Added Tax*; raw materials, tools and consumables, spare parts and components pay only 50 per cent of customs duty for the first 2 years; amortization of technology within 5 years; transfer of losses for 5 consecutive years. These facilities are subject to the following conditions:

- investment should be not less than 350 thousand dollars and not less than 20 percent participation in an enterprise.

• *Profitability of investment and investitures costs:*

- Income tax for the first two years is 15 percent. Fixed rate of income tax is 38 percent.
- For investments over $ 5 million, this level of income tax (15 percent) is offered for other 5 years. In this case, 50 percent of reduction in customs duty that was mentioned above is provided for 3 other years.

Summarizing these figures in a table we would have this scheme:

Table 5. Data from the study of the countries in the Region

	Costs before investment		**Profitability**		**Remarks**
	Customs duties in %	VAT, in %	Profit tax in%	Withholdings, in%	Other influential elements.
Albania	5	20	15	10 (15)	No facility
Macedonia	0	5	15	23	• 3 years income tax exemption; •reinvestment is excluded from income tax
Bulgaria	0	0	40	10 (15)	• 3 years profit tax exemption; • 20% income tax for the 3 other years.
Romania	0	0	38	-	• 15% income tax for the first 2 years; • 15% income tax for 5 other years for investments over 5 million $.

Table 6. VAT performance compared to countries in the Region and EU countries

	Country	First year of VAT	VAT rate	Reduced VAT	PROD VAT	Threshold VAT	AG VAT	IMP VAT	INF VAT
1	Montenegro	2003	17	-	0.84	18.391	10	74.7	-0.5
2	Croatia	1998	22	10	0.55	11.897	7	50.3	2.3
3	Bosnia and Herzegovina	2006	17	-	0.74	26.071	8	62	1.6
4	Bulgaria	1994	20	7	0.56	26.120	5	83.3	3.3
5	Slovenia	1999	20	8.5	0.42	25.543	2	71.5	2.1
6	Serbia	2006	18	8	0.57	22.426	13	52.4	4.8
7	Hungary	1988	25	-	0.40	3.759	4	80.2	3.6
8	Kosovo	2001	16	-	0.59	51.064	12	56.9	1.5
9	Czech Republic	1993	19	-	0.35	38.532	2	72.5	1.8
10	Romania	1993	19	9..5	0.42	35.760	7	40.4	3.45
11	Macedonia	2000	18	5	0.50	20.606	11	78.6	1.9
12	Italy	1973	21	10..4	0.38	0	2	29.3	3.1
13	Slovakia	1993	19	10	0.36	35.760	3	85.3	4
14	Albania	1996	20	10	0.49	36.453	20	59.4	3.4
15	Greece	1987	23	13..6,5	0.33	10.213	3	31.9	3.1
16	Turkey	1985	18	8..1	0.27	0	10	28.4	6.15

Source: OECD, FMN

The first column shows the first year of VAT application, in 16 states. In two columns are shown the standard and reduced rates. Albania has similarities with Italy, Slovakia, Croatia, and Slovenia. While Montenegro, Bosnia, Hungary, Kosovo, the Czech Republic have not reduced tax rates. With lower VAT productivity is presented Turkey, 0.27 percent. Montenegro performs better with 0.84 percent. In this regard Albania is ranked in the 9th place.

Regarding the VAT threshold, except Turkey and Italy that do not have turnover threshold

as part of the VAT scheme, Hungary has the lowest turnover threshold with 3.759 Euro and Kosovo has the highest turnover threshold with 51.064 Euro. Albania with the changes in 2010 has a high threshold compared to other countries (with 36.453 Euro).
Three recent columns, intended to show the structure of the dependence of the economy on agriculture and imports, as well as the impact of inflation in productivity. The data can be used directly to make comparisons with other countries.
The Albanian government is also trying to resolve weaknesses in tax policy and tax administration by adopting a series of measures to solve these problems. Measures adopted by the government to improve tax performance are:

- *The modernization of the tax administration through:*
  - i. Improved information system for taxpayers.
  - ii. Computerization
  - iii. Elaboration of new tax laws and procedures.
  - iv. Presentation of identification numbers for taxpayers
  - v. Creation of a tax appeal system.
  - vi. Improving the audit and investigation system.
  - vii. Creation of a Big Taxpayers Unit

- *Improving tax policy through:*
  - i. Introduction of VAT to replace turnover tax
  - ii. Tax reform in coordination with trade liberalization agenda.
  - iii. Development of appropriate tax for Local Government.
  - iv. Simplification of the tax system.

These reforms are elaborated to involve additional resources through efficient generation of profits and tax network expansion. This general policy will also lower the taxes on current taxpayers and as a result will promote private sector development.

5. CONCLUSION

- Fiscal policies of government should stimulate through the tax system and legislation, enterprises that have more priority under long-term development specifications because only a long term consolidated enterprise can compete in an open market of the European Union.
- Implementation of policies should be accompanied by reforms in the tax system in order to:

  - reduce the gap of taxpayer compliance with the law
  - reduce tax evasion
  - reduce the informal sector
  - eliminate the abuse of tax structures
- If VAT is not properly administered it may degenerate into a tax that deforms the tax system, which interrupts the economic growth and its sector specialization by converting into a tax (weight) on accumulated turnover. Revenues from the value added tax are often lower than expected because they are difficult and expensive to collect and manage. It is necessary to properly manage the VAT by increasing the use of available capacities and fight corruption.
- A reduction of VAT which would bring tax pressure reduction and would

increase tax statements and incomes.

- Implementation of different tax rates for VAT on primary consumable products
- The introduction of VAT in all types of business except for professional business

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