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## **Albania**

# **Tax Policy Reform Options for the MTRS**

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**Technical Report**

**February 2020**

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## ABBREVIATIONS AND ACRONYMS

ALB	Republika e Shqipërisë (Republic of Albania)
ALL	Albanian Lek
BERD	Business enterprise research and development
BIH	Bosna i Hercegovina (Bosnia and Herzegovina)
BGR	Republika Bŭlgariya (Republic of Bulgaria)
CEE	Central and Eastern Europe
CIT	Corporate Income Tax
CZE	Česká republika (Czech Republic)
EUR	Euro
GDP	Gross Domestic Product
GDT	General Directorate of Taxation (Drejtoria e Përgjithshme e Tatimeve)
HRV	Republika Hrvatska (Republic of Croatia)
HUN	Magyarország (Hungary)
IBFD	International Bureau of Fiscal Documentation
ILO	International Labour Organization
IMF	International Monetary Fund
ISO	International Organization for Standardization
MKD	Република Северна Македонија (Republic of Macedonia)
MNE	Црна Гора (Montenegro)
MoF	Ministry of Finance
MTRS	Medium-term Revenue Strategy
PIT	Personal Income Tax
POL	Rzeczpospolita Polska (Republic of Poland)
PPP	Purchasing Power Parity
OECD	Organisation for Economic Cooperation and Development
ROU	România (Romania)
SDG	Sustainable Development Goal
SEE	Southeastern Europe
SPT	Simplified Profits Tax
SRB	Republika Srbija (Republic of Serbia)
SVK	Slovenská republika (Slovak Republic)
SVN	Republika Slovenija (Republic of Slovenia)
US\$	United States Dollar
VAT	Value-added Tax
WEO	World Economic Outlook
WHO	World Health Organization

## PREFACE

In response to a request from the Minister of Finance, Ms. Anila Denaj, for capacity development in the preparation of a medium-term revenue strategy, a mission advising on the tax policy aspects of this strategy visited Tirana during November 1–12, 2019. This mission of the International Monetary Fund's (IMF) Fiscal Affairs Department (FAD) comprised Ms. Dora Benedek (head), Mr. Aqib Aslam, and Ms. Nariné Nersesyan (both FAD). The mission partly overlapped with a mission advising on the revenue administration aspects of the strategy, also of the IMF FAD, led by Mr. Stephen Vesperman.

The mission had several rounds of productive discussions with the following officials and members of their staff: Mr. Elton Haxhi (Deputy Minister of Finance); Mr. Ylber Karanxha (Director of GDC); Ms. Arjana Dyrmishi (Advisor to the Minister); Mr. Nikolla Lera (Director, General Directorate of Macroeconomics and Fiscal Policy); Ms. Enkeleida Pipa (Director, Fiscal Harmonization Directorate); and Mr. Artan Gjoka (Director of Fiscal Cadaster).

A meeting with World Bank colleagues proved as usual very useful for coordination purposes.

The mission is grateful for the hospitality of the authorities and the efficient support provided in organizing and facilitating the discussions. The mission would also like to thank Ms. Linda Spahia (IMF Resident Representative office) for her assistance during the preparation of the mission. The mission also acknowledges excellent interpretation by Ms. Arlinda Gjebrea and Ms. Engjellushe Shqarri.

## EXECUTIVE SUMMARY

**Albania is preparing a Medium-Term Revenue Strategy (MTRS) to finance its development spending of an estimated 2.2–3.0 percent of GDP over five years.** Revenue mobilization will be supported by comprehensive tax policy and administration reforms. International and regional comparisons suggest that there is room for additional revenues as well as improvement in the composition of tax revenues. This report presents options for tax policy reform to raise at least an additional 1.34 percent of GDP in revenues over five years and to improve the quality and efficiency of the tax system, that will enable the mobilization of further domestic revenues.

**While the rates for all major taxes are in line with regional peers, the overall tax-to-GDP ratio lags behind comparator countries.** This can result from narrow tax bases and/or inefficient enforcement and collection. The high reliance on indirect taxes, especially on VAT is also striking, while social security contribution revenues are lower than the regional average. The current tax system is complex and fragmented, and frequent ad hoc changes have been undermining the stability and transparency of the system. A fairer, more efficient, simpler, and more transparent tax system could make Albania more attractive for foreign investment, while also invigorating domestic economic activity by instilling the right economic incentives and confronting the current high level of informality.

**To assess and plan the tax policies required for an efficient implementation of the MTRS, the Ministry of Finance requires a dedicated tax policy function.** This unit should collect data and develop expertise to assess taxes and tax expenditures, both in terms of revenues and their economic costs and benefits and should be staffed appropriately.

### Consumption Taxes

**VAT contributes about half of tax revenues, with a relatively high standard rate (20 percent), but its efficiency is low compared to others in the region.** Excises and national taxes also deliver a large share of revenues. Both VAT and excise rules are in line with international standards, but a very broad range of goods, services and taxpayers are exempt from indirect taxes, undermining the efficiency of collection. The authorities' estimate on the revenue forgone through indirect tax exemptions, reduced rates, and other beneficial treatments is around 5.5 percent of GDP, but that comprises both the policy and compliance gaps.

**Within the VAT, a large share of final consumption is exempt, such as education, health, medicines and similar products, sale of new property, and financial services.** Some of these exemptions are based on equity grounds, but this is an expensive and poorly-targeted means of support. The mission recommends that private education, health, non-prescription medicines and similar goods, as well as fee-based financial services and the first sale of newly-built property be subject to VAT.

**The VAT threshold has been lowered recently and consequently very low within the region.**

The intention of lowering the threshold was to address informality, but the tax administration does not have capacities to effectively monitor this large taxpayer segment. Furthermore, there are multiple thresholds in place for different sectors undermining simplicity. The VAT threshold should be set higher, e.g., at ALL 8 million, to allow the administration to focus on segments which contribute much higher shares of revenue and applied to all taxpayers. Voluntary registration should be restricted to businesses only with turnover between ALL 5–8 million.

**All non-standard exemptions, reduced rates and beneficial treatments should be eliminated from the VAT, excises, and national taxes.** They unnecessarily complicate the system, undermine its integrity and make it very difficult to administer efficiently. Tax administration issues, such as problems with VAT refunds, should not be addressed with tax policy instruments and support to certain groups or sectors should take the form of direct subsidies that are easier to monitor, control, and contain, than tax expenditures. Eliminating exemptions and reduced rates along these lines would increase revenues from indirect taxes (by at least 0.2 percent of GDP) and substantially improve the quality and efficiency of the tax system, which would further enhance revenue collection in the medium term.

## **Income Taxes**

**Direct income taxes raise less revenues in Albania than in comparable countries.** They contribute around 20 percent of total tax revenues, gradually increasing from 3.7 to 4.4 percent of GDP between 2014 and 2018. Income-based social contributions add an additional 6 percent of GDP, and social contributions and tax revenues together raised about 26 percent of GDP as of 2018.

**While Albania has the ingredients of a modern income tax system, the design of certain features—for example, a progressive personal income tax (PIT), a graduated general business profits tax, a simplified profits tax, and social security contributions—and the way they interact, make it overly complex, generating distortions and non-neutrality.** For example, multiple thresholds fragment the income tax bases and the applicable tax rates. The complex set of rules provides incentives and opportunities for taxpayers to minimize or avoid payment.

**The current system provides incentives for individuals performing identical economic activities to choose self-employment (under the business profits tax) over employment (under the PIT).** Alongside such non-neutrality, the tax system is struggling with a high degree of informality which is encouraged by the high compliance costs and excessive complexity. Furthermore, the tax authority is unable to build a complete picture of individual taxpayers because not everyone is required to file a tax declaration and the revenue administration is unable to collect data from third parties (e.g., banks, property registers, etc.) to cross-check information.

**Albania needs a comprehensive tax system covering all taxpayer groups with fair rules and the right incentives, to make sure that everyone pays a fair tax burden.** Profits taxation has a substantial compliance burden for businesses to maintain a certain level of records, and for this reason, only larger businesses should be subject to such obligations in the general business profits tax scheme. For smaller businesses, below an ALL 8 million threshold, the simplified profits regime should be converted into a simplified presumptive regime with a turnover threshold and a lower tax rate, 3 percent, on turnover. The smallest taxpayers, below, e.g., ALL 1 million turnover, should pay a flat presumptive fee of around ALL 50,000 per year.

**The current PIT rates support progressivity, but many people underreport their income, undermining the equity and progressivity that was the original intention for the current PIT regime.** PIT and social security thresholds should be harmonized to reduce complexity, and the overall tax burden on labor should not hinder the path to formalization for small businesses. Professionals should be taxed under the PIT to increase fairness and the tax system should remain broadly neutral across different forms of employment. Furthermore, to help with sound policy analysis, it is important for the tax administration to collect information on all employees, self-employed businesses, and companies.

### **Other Recommendations**

**Property and environmental taxes are efficient sources of revenues, that are underutilized in the Albanian tax system.** Both property and environmental taxes are based on the right principles, but the tax rates are very low, and the broad range of exemptions keep revenues below potential. Simplifying the rules of the plastic waste charge and raising tax rates could potentially raise an additional 0.2–0.5 percent of GDP revenues. Similarly, raising the rate of the property tax, after the fiscal cadaster has been fully developed, could provide an additional 0.3–0.5 percent of GDP revenues.

**Table 1. Albania: Summary of Tax Policy Reform Recommendations**

	Timing	Revenue impact				
		2020	2021	2022	2023	2024
<b>I. Tax reform strategy</b>						
1 Increase stability of the tax system by minimizing frequent changes.	Immediate					
2 Strengthen capacity for tax policy analysis and assessment.	Immediate					
3 Strengthen capacity of the General Directorate of Fiscal Policy in the Ministry of Finance to manage the implementation of the MTRS.	Immediate					
<b>II. Consumption taxation</b>		<b>0.07</b>	<b>0.32</b>	<b>0.42</b>	<b>0.42</b>	<b>0.42</b>
1 Tax health and education services provided by the private sector under the VAT.	3 years			+	+	+
2 Tax non-prescription drugs, medicines and related products under the VAT, preferably at the standard rate.	3 years			+	+	+
3 Tax all fee-based financial services under the VAT. In the long term consider unifying the tax treatment of financial services and insurance under the VAT.	3 years			+	+	+
4 Tax the first sale of new residential property under the VAT. Subsequent sales of residential property and long-term rentals and leases should remain exempt.	2 years			+	+	+
5 Eliminate the 6 percent reduced rate. Tax accommodation and other services under the VAT at the standard rate.	2 years			0.1	0.1	0.1
6 Carefully review all VAT exemptions; eliminate those without a sound justification.	1 year					
7 Eliminate zero-rating on inward processing arrangements.	3 years					
8 Reduce the number of fiscal warehouses and suspension regimes to facilitate monitoring and enforcement.	3 years					
9 Raise the VAT threshold to ALL 8 million; allow voluntary registration for taxpayers with turnover between ALL 5-8 million, but not below (see III. 4).	2 years					
10 Apply VAT threshold consistently across all taxpayers, regardless of their activity. Tax professionals on their income in the PIT (see III.5).	2 years					
11 Phase out the 6 percent compensation scheme for farmers. Replace it with targeted benefits for the agriculture sector that are much easier to contain and monitor.	3 years				+	+
12 Eliminate the differentiated excise rate between small and large beer and wine producers. All excises should be set at the regular level, both for beer and wine.	Immediate	0.05	0.05	0.05	0.05	0.05
13 Consider lowering and enforcing the level of alcohol for own consumption that does not attract tax.	2 years			+	+	+
14 Eliminate exemptions from fuel excises.	Immediate	0.02	0.02	0.02	0.02	0.02
15 Introduce automatic indexation of specific excise rates.	Immediate	+	+	+	+	+
16 Eliminate exemptions and refunds from national taxes and fuel excises and replace them with direct subsidies.	Immediate	+	+	+	+	+
17 Increase the specific charges payable on plastic bags, packaging, plastic bottles (to EUR 5-10/kg), and aluminum cans, and encourage recycling through refund mechanisms. Support the environmental charging regime with supporting regulation.	2 years		0.25	0.25	0.25	0.25
<b>III. Income taxation</b>		<b>0</b>	<b>0.62</b>	<b>0.62</b>	<b>0.62</b>	<b>0.62</b>
1 Unify the tax rate in the general business profits tax regime to 15 percent.	3 years			+	+	+
2 Remove reduced business profits tax rates and exemptions for priority sectors.	3 years			+	+	+
3 Switch from profit-based incentives to cost-based incentives for priority sectors.	3 years			+	+	+
4 Introduce a simplified presumptive turnover-based regime for small businesses with turnover below ALL 8 million and a rate of 2-3 percent (calibrate rate based on taxpayer data).	2 years		0.22	0.22	0.22	0.22
5 Bring self-employed professional individuals into the personal income tax system.	2 years		0.4	0.4	0.4	0.4
6 Remove the ALL 2 million individual personal income declaration threshold.	2 years					
7 Consider improving progressivity within the personal income tax regime.	3 years					
8 Align social security contribution caps with upper threshold of the personal income tax.	3 years		+	+	+	+
<b>IV. Property taxation</b>					<b>0.3</b>	<b>0.3</b>
1 Eliminate exemptions from the property tax.	3 years					
2 Raise property tax rates.	3 years					
<b>Total</b>		<b>0.07</b>	<b>0.94</b>	<b>1.04</b>	<b>1.34</b>	<b>1.34</b>

Source: IMF staff calculations.

# I. INTRODUCTION

**1. Albania has decided to adopt a Medium-Term Revenue Strategy (MTRS) to finance its development needs and boost its growth potential as it strives to meet its Sustainable Development Goals (SDGs).** The government has assessed the country's additional spending needs and estimated them at 2.2–3.0 percent of GDP over a five-year horizon. Albania plans to finance this gap with revenues from comprehensive tax policy and administration reforms. This report presents options for tax policy reform to raise at least an additional 1.34 percent of GDP in revenues over five years and to improve the quality and efficiency of the tax system, that will enable the mobilization of further domestic revenues. Reform options for tax and customs administration will be discussed in a separate report.

**2. International and regional comparison suggests that there is room for additional revenues as well as improvement in the composition of tax revenues.** While tax rates for all major taxes are in line with regional peers, the overall tax-to-GDP ratio lags behind comparative countries. This can result from narrow tax bases or inefficient enforcement and collection. The high reliance on indirect taxes, especially on VAT is also striking, while social security contribution revenues are lower than the regional average.

**3. While domestic revenue mobilization is at the center of the MTRS, Albania has also set out to improve the quality of the tax system by making it more efficient.** The current tax system is complex and fragmented. Exemptions and beneficial treatments for various taxpayer groups and sectors have been proliferating in previous years in response to pressures from lobby groups and difficulties with administration, undermining the stability and transparency of the system. A fairer, more efficient, simpler, and more transparent tax system could make Albania more attractive for foreign investment, while also invigorating domestic economic activity. It would not only make administration and enforcement easier but also set the right economic incentives. Together with the planned increase in investment in human and physical capital, in line with the SDGs, an improved tax system can help put Albania on a higher, more sustainable economic growth path. Principles of sound tax policy are discussed at the end of this section.

**4. Effective planning and implementation of an MTRS—as well as sound tax policy assessment—require a dedicated function in the Ministry of Finance (MoF).** This unit should collect data and develop expertise necessary for policy and cost-benefit analysis. It should be staffed adequately, and continuity should be ensured for cases of staff turnover. Grote (2017)<sup>1</sup> discusses in details the requirements and operation of such unit.

**5. Albania has received several tax policy related IMF Technical Assistance missions over the last decade.** Previous IMF Technical Reports from the last five years are i) Jensen et al: Causes of Tax Revenue Underperformance and Options for Corrective Measures, August 2015;

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<sup>1</sup> Grote, Martin. (2017). "How to establish a Tax Policy Unit." IMF How-to Note No. 17/02.

ii) Caner et al: Guidance on Tax Expenditure Assessment and Advancing Property Tax Reform, February 2017; iii) Grote et al: A Value-Based Property Tax: Review of Policies, Draft Legislation and Implementation Steps, October 2017; iv) Nersesyan et al: Evaluation of Proposed Changes to Value-Added Tax and Income Taxation, December 2017; v) Schatan et al: Tax Treaty Policy and BEPS Issues, November 2018; and vi) Baunsgaard et al: Reforming the Petroleum Fiscal Regime, August 2018. This report does not replicate the analysis and recommendations of these previous reports. Instead it focuses on developing a menu of options that the government can incorporate in their MTRS covering the next five years, building on previous findings. A summary of the most important past recommendations can be found in Annex II.

**6. To facilitate policy analysis underpinning the MTRS, the mission has developed 3 models based on microdata received from the authorities:** i) a VAT model calculating revenue forgone from exemptions and reduced rates, used for scenario analysis for VAT changes; ii) a PIT microsimulation model, also incorporating social security contributions, used for scenario analysis and calculations of labor tax wedge; and a iii) tax model calculating and analyzing reform proposals regarding small enterprises. The mission has presented and handed over these models to the staff of the Ministry of Finance.

### Principles of Sound Tax Policy

**7. Good tax policy plays an important part in sustainable development, although it faces somewhat conflicting objectives:**

- **Revenue mobilization:** the tax system needs to raise sufficient revenues to finance public spending, such as the functioning of government, social benefits, public investment, etc.
- **Efficiency:** the tax system needs to be *transparent, simple, stable, and minimize distortions to taxpayer behavior*. It should be *fair and neutral* between different types of taxpayers in similar economic situations.
- **Equity:** the tax system should be *just and inclusive*, and contribute to the distributional objectives, together with the social benefit system. Taxpayers should contribute to public finances according to their ability to pay.

**8. In addition to revenue mobilization, the simplicity, inclusiveness, transparency, and equity of the tax system all play important roles in establishing its legitimacy.** Efficient taxes also serve as a useful anchor for investors' and taxpayers' long-term expectations. The stability and transparency of taxes help businesses to plan and attract foreign investment.

**9. In the presence of high informality, the tax system should be based on a relatively small number of taxes with a single or very few tax rates on broad bases.** This facilitates assessment and administration, especially when capacities are limited. While sophisticated tax rules may help to improve efficiency and equity, they are costly to assess and audit for the

administration, and to comply with for the taxpayers. Exemptions create loopholes that can lead to tax arbitrage and undermine revenues. Tax expenditures through exemptions, reduced rates, and other beneficial treatment should be reviewed and assessed on a regular basis to understand their efficacy and revenue impact.

**10. The MoF in Albania has started calculating the revenue forgone through tax expenditure with the intention of publishing a tax expenditure report.** The estimated cost of tax expenditures in 2018 is 5.6 percent of GDP, most of which comes from the VAT, but tax expenditures are also granted from customs duties, excises, the business profits tax, and the PIT. Small businesses, professionals, and farmers are three groups that benefit from exemptions across the board. Some tax expenditures, while present in the law, are not utilized, such as tax benefits for special economic zones or benefits for branded five-star hotels. These special tax treatments will be discussed under the taxes that they concern.

### **Box 1. Most Important Benefits Provided Through the Tax System to Priority Sectors**

Albania provides many benefits through its tax system to selected priority sectors. These are much less transparent than direct subsidies, and therefore it is difficult to assess the total amount spent on these sectors by the budget.

#### **1. 4-/5-star hotels (with internationally-recognized trademarks/brands):**

- CIT: exempt (0 percent rate)
- VAT: 6 percent rate on all activities
- Exemption from infrastructure impact tax
- Exemption from property tax

#### **2. Agrotourism:**

- CIT: 5 percent rate
- VAT: 6 percent on accommodation and restaurant services
- Exemption from infrastructure impact tax

#### **3. Farmers, agrobusinesses:**

- CIT: agriculture cooperatives: 5 percent rate; farmers: exempt
- PIT: farmers exempt
- VAT: exempt inputs; 6 percent flat-rate compensation scheme; higher registration threshold (ALL 5 million)
- Excises: exemption from vehicle tax for agricultural machines
- Social security contributions: reduced fixed payment (determined by geographic location)

## II. PLACING ALBANIA'S TAX SYSTEM IN REGIONAL CONTEXT

### A. The Performance of Albania's Tax System

**11. Albania has been developing a modern tax system over time with a mix of direct and indirect taxes to help achieve its revenue needs.** As of 2014, Albania moved away from a direct tax system of flat rates to one with progressive personal income tax and business income tax, with a separate scheme for small businesses under the latter. Indirect taxes comprise the value-added tax (VAT), excises, and 11 smaller “national taxes”—these are essentially a mix of additional excises that include a tax on plastic packaging, a used car tax, a carbon tax, registration and usage fees for luxury cars, and a circulation tax on petrol and diesel. Albania's VAT has been in place since 1995 and has been broadly aligned with the European Union's Sixth Council Directive on the common system of the VAT.

**12. Tax revenues as a share of GDP fell following the global financial crisis (2008–10) and have only gradually begun to recover.** After steady increases over the period 2000–08, tax revenues began to fall to a low of 17.5 percent of GDP in 2013 (Figure 1, panel 1). Subsequently, the relationship between tax revenue growth and GDP growth has become more erratic in recent years (Figure 1, panel 2). This could be linked to any number of factors relating to the economic outlook—including business and consumer confidence—as well as the stability and integrity of tax policy and administration.

**13. Indirect taxes are the workhorse of the Albanian tax system.** These taxes on goods and services provide up to two thirds of Albania's tax revenues. VAT revenues have averaged just under 9 percent of GDP over the last 5 years, contributing around 45 percent of total tax revenues (Figure 1, panels 3 and 4). As the largest and most important component, VAT revenues also inevitably drive variability in overall tax revenue growth, which highlights the importance of maintaining a robust and stable VAT for tax revenue stability. Excises duties are derived almost entirely from fuel and tobacco products (54 and 36 percent of total excises, respectively).

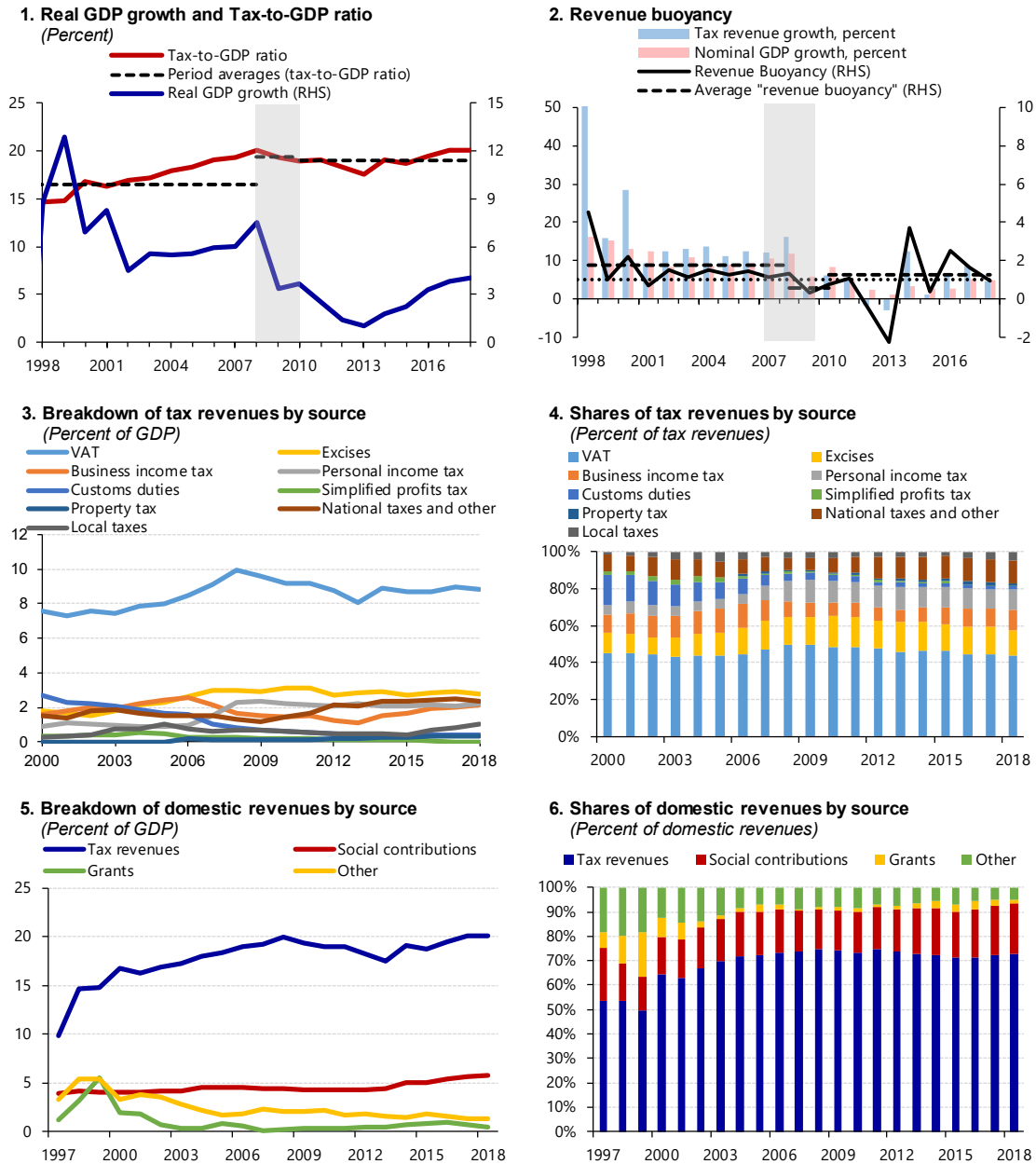
**14. Direct income taxes have proven less important to revenue mobilization in Albania.** The personal income tax (PIT), business income tax, and the simplified profits tax contribute only around 20 percent of total tax revenues, gradually increasing from 3.7 to 4.4 percent of GDP between 2014 and 2018 (Figure 1, panels 3 and 4). On top of the 72.5 percent of domestic revenues coming from the tax system, income-based social contributions make up 20.7 percent to overall domestic revenues.<sup>2</sup> By adding 5.7 percent of GDP to total domestic revenues, social

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<sup>2</sup> Under the 2014 Government Financial Statistics Manual, social contributions are classified separately from tax revenues, as actual or imputed revenue receivable by social insurance schemes to make provision for social insurance benefits payable. Social contributions include payments made by insured persons, or their employers, (continued...)

contributions and tax revenues together raise 25.8 percent of GDP as of 2018 (Figure 1, panels 5 and 6).

**Figure 1. Albania's Domestic Revenue Performance**



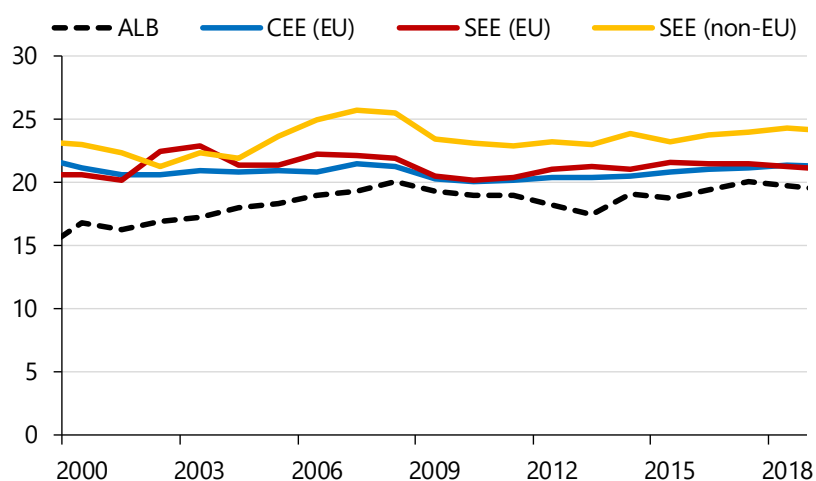
Sources: Albania Ministry of Finance; IMF, World Economic Outlook, and IMF staff calculations.  
 Notes: RHS=right-hand side; VAT=value-added tax.

to secure entitlement to social benefits. The contributions are levied as a function of earnings, payroll, or the number of employees.

## B. Albania and its Regional Comparators

**15. Albania has been lagging regional average tax-to-GDP ratios over the last two decades (Figure 2).** Albania's tax system outcomes are compared with those from three groups of economies in the region: central and eastern European (CEE) EU member countries (Czech Republic, Hungary, Poland, Slovakia, and Slovenia); southeastern European (SEE) EU member countries (Bulgaria, Croatia, and Romania), and southeastern European (SEE) non-EU countries (Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia).

**Figure 2. Albania vs. Regional Comparators, Tax-to-GDP Ratio, Percent**



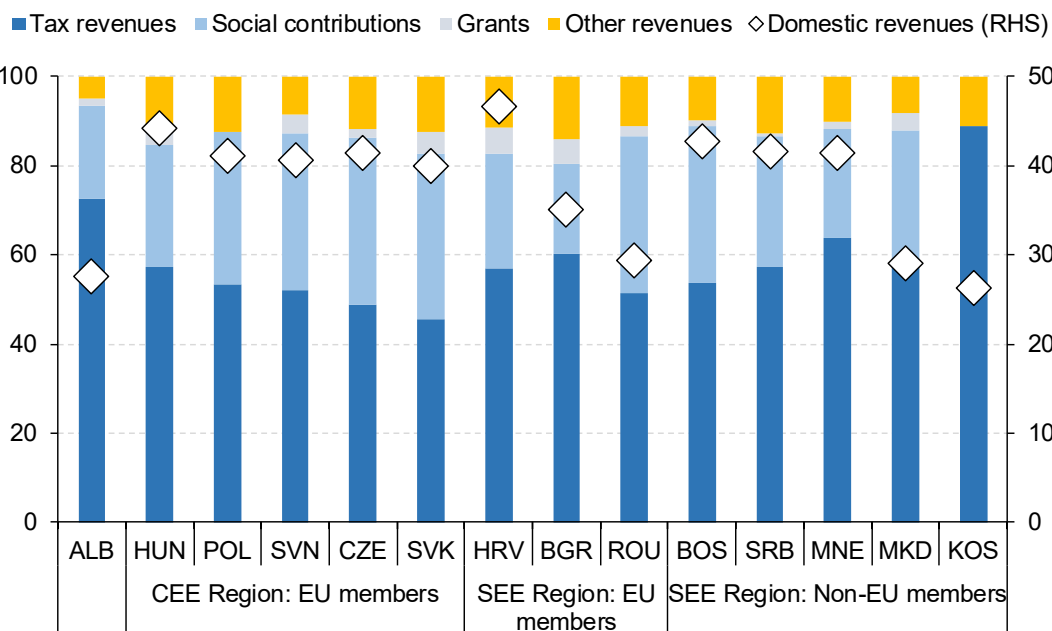
Sources: IMF, World Economic Outlook, and IMF staff calculations.

**16. Albania shares many domestic revenue characteristics with its regional neighbors.** Tax revenues and social contributions are the mainstay of domestic revenue mobilization across all countries in the region, contributing on average 21.8 and 12.2 percent of GDP, respectively (Figure 3, panel 1). But while tax revenues have raised a similar amount for Albania as for the region on average (around 20 percent of GDP), social contributions in Albania are less than half of what other countries in the region collect. Other countries in the region are also similarly dependent on revenues from the taxes on goods and services. This category is the most significant component for all countries from the region, bringing in two-thirds of the total on average (Figure 3, panel 2). On the other hand, as in Albania, direct income taxes—personal and business income taxation—contribute less than 6 percent of GDP on average to domestic revenues across the region.

**Figure 3. Domestic Revenues by Type, 2018**

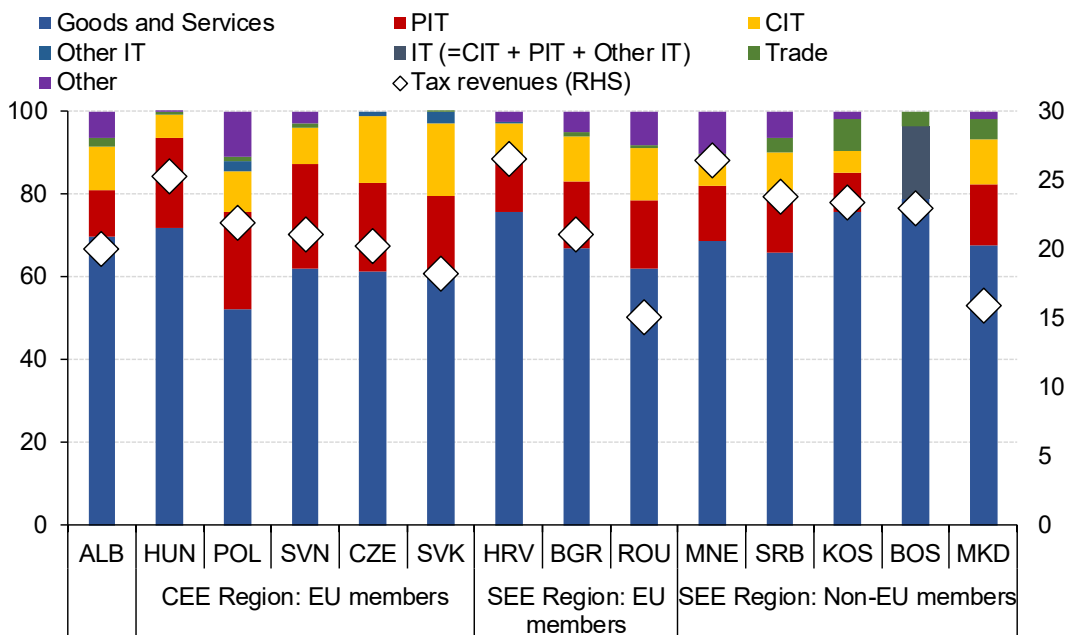
**1. Breakdown of domestic revenues**

(LHS: Percent of domestic revenues; RHS: Percent of GDP)



**2. Breakdown of tax revenues**

(LHS: Percent of tax revenues; RHS: Percent of GDP)

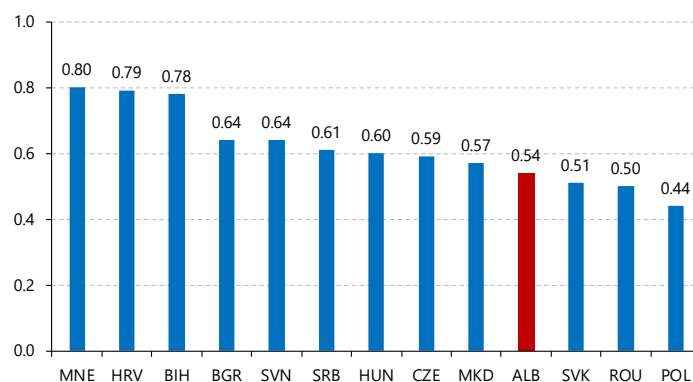


Sources: IMF, World Economic Outlook, and IMF staff calculations.

Notes: IT=income tax; CIT=corporate income tax; PIT=personal income tax; ALB=Albania; BOS=Bosnia and Herzegovina; BGR=Bulgaria; CZE=Czech Republic; HRV=Croatia; HUN=Hungary; KOS=Kosovo; MKD=North Macedonia; MNE=Montenegro; ROU=Romania; SRB=Serbia; SVK=Slovak Republic; SVN=Slovenia.

**17. With a high rate and low threshold, Albania’s relatively low VAT C-efficiency points to structural issues in the VAT.** Albania’s C-efficiency ratio is 0.54, which means the authorities only collect 54 percent of total VAT revenue compared with the benchmark that taxes all final consumption at the standard rate (Figure 4). At 20 percent, the standard VAT rate in Albania is above the average of its immediate regional non-EU neighbors, while close to or just below those of EU comparator countries (Table 2). Furthermore, the recently lowered VAT threshold for small businesses of ALL 2 million<sup>3</sup> is the lowest of all regional comparator economies—the previous threshold of ALL 5 million was far more comparable. Therefore, with a reasonable rate and low threshold, this would suggest both design and implementation issues that could be undermining VAT performance, such as the breadth of the base and compliance.

**Figure 4. VAT C-Efficiency Ratio 1/**



Sources: IMF staff calculations.

1/ Ratio of actual VAT revenues to theoretical revenues from a perfectly enforced VAT levied at the uniform standard rate on all final consumption.

**18. Direct taxation in the region is characterized by relatively low flat rates on capital income and limited progressivity on labor income (Table 2).** Many countries in the region apply a relatively low flat rate on labor income (Bosnia and Herzegovina, Bulgaria, Czechia, Hungary, North Macedonia, Romania, Serbia) at either 10 or 15 percent. At the same time, capital income is taxed by some countries at lower rates (Croatia, North Macedonia, Slovakia, and Slovenia), broadly equal rates (Bosnia and Herzegovina, Bulgaria, and Montenegro) or higher rates (Czechia, Kosovo, Romania, and Serbia) than labor income. Depending under which scheme income from self-employment and employment is taxed, excessive differentiation in rates can create incentives for individuals to choose a particular legal form simply to avoid tax. Furthermore, where capital income is taxed at significantly lower rates, those countries are likely to find businesses have an incentive to incorporate in order to take advantage of lower CIT rates—and any preferential rates for specific sectors—and other advantages such as low rates of dividend taxation.

<sup>3</sup> The ALL/USD exchange rate was around 110 ALL/USD at the time of the writing of the report.

**19. However, Albania stands out when it comes to both its progressive business profits and personal incomes taxes.** Albania's business profits tax rate of 15 percent is above the average of the two groups of southeastern European economies—only Croatia has a higher rate, while Serbia has a matching rate—while 2 other countries have reduced corporate income tax rates: Croatia and Poland. Albania also stands out in the region as it operates an additional simplified regime for small businesses—only its immediate neighbors (Kosovo and North Macedonia) operate similar schemes, as well as Hungary and Romania.

**20. Revenues from labor income—personal income taxation and social contributions—are an important source of domestic revenues for Albania and countries in the region.** Data shows that approximately 40 percent of domestic revenues in the region (excluding Albania) are raised through revenues from personal income taxes and social contributions, corresponding to an average of 16 percent of GDP. Furthermore, it is social contributions that provide on average about 75 percent of these revenues from labor income. While Albania has a similar share of revenues from labor income attributable to social contributions, revenues from labor income form only about 30 percent of total domestic revenues.

**21. Albania has one of the most progressive income tax schedules in the region.** This means that larger incomes from employment in Albania are taxed at higher rates than others in the region, providing greater vertical equity than most of neighboring countries (Figure 5, panels 1 and 2). However, as we will discuss later, this system has created some perverse incentives due to the exclusions of income from self-employment from the PIT—instead it is taxed under the highly progressive business profits tax regime with considerably lower rates over larger amounts of income than the PIT. Also, the high informality and underreporting undermines the progressivity of the PIT system. However, the larger EU member economies of central and eastern Europe show much greater dispersion in progressivity, given the choice of the Czech Republic and Hungary to maintain flat PIT rate structures (Figure 5, panel 3).

**22. More generally, the high labor tax wedge, when combined with other structural rigidities, has led to unsatisfactory economic outcomes across the region.** The legacy of persistent high labor taxes and large social security programs has contributed—amongst other socio-economic and demographic factors—to high youth and female unemployment, low labor force participation, and high levels of informality. Labor force participation rates by international standards are some 5–10 percentage points lower than EU-28 and OECD averages (Figure 6, panel 1). Furthermore, according to data from the International Labour Organization, Albania has a relatively much higher rate of informality in non-agricultural employment (31.9 percent) than North Macedonia (9.0 percent) and Serbia (13.8 percent). In addition, while the level of the tax wedge across SEE (non-EU) countries, including Albania, does not particularly stand out when compared to EU and OECD countries, the limited progressivity originating from the flatter nature of PIT levied on wages does (Figure 6, panel 2, from Jankulov Suljagic 2019).<sup>4</sup> Explanations vary

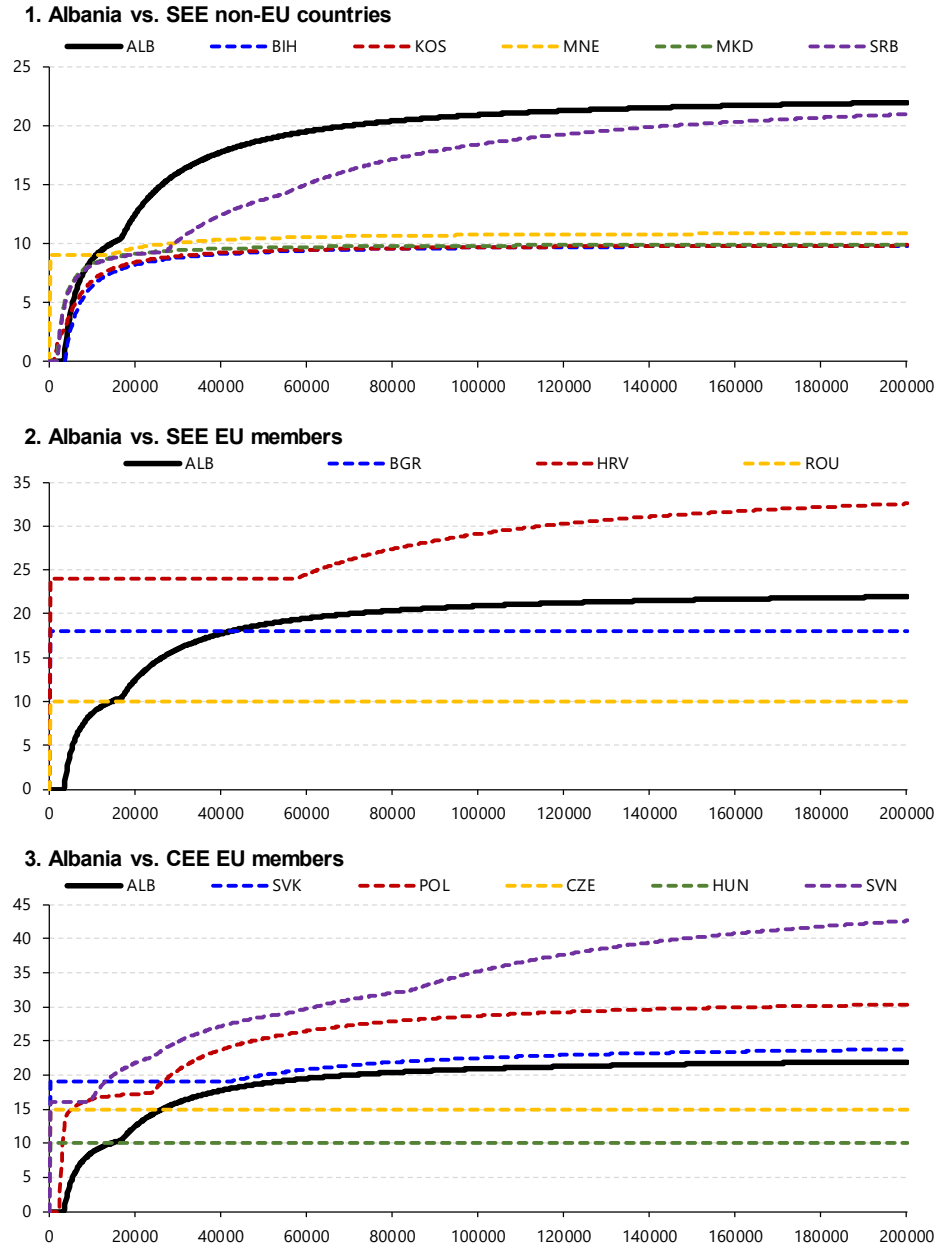
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<sup>4</sup> The impact of limited progressivity shows up in the relatively limited dispersion between the wedges calculated over the three different percentages of the average wage.

from differing social preferences for work and leisure and country specific effects related to transition or a post-conflict environment, to outward migration. Significant remittance flows can also lead to informality and lower employment by increasing local reservation wages.

**Figure 5. Effective Tax Burden for Income from Employment**

(Y-axis: percent; X-axis: US\$)

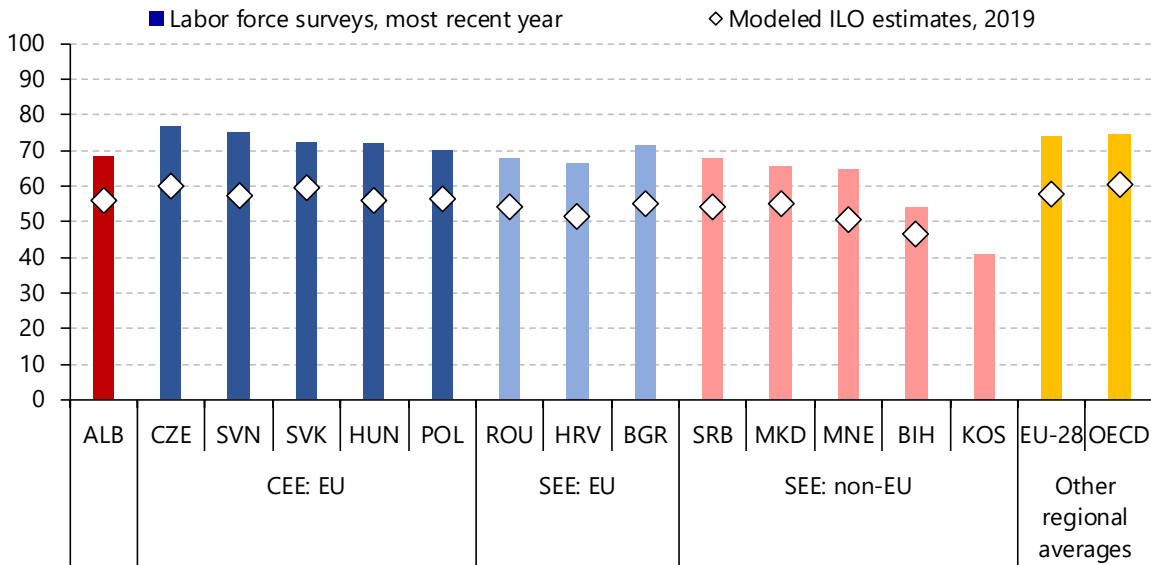


Sources: IMF staff calculations.

Notes: CEE=central and eastern Europe; SEE=southeastern Europe; ALB=Albania; BOS=Bosnia and Herzegovina; BGR=Bulgaria; CZE=Czech Republic; HRV=Croatia; HUN=Hungary; KOS=Kosovo; MKD=North Macedonia; MNE=Montenegro; ROU=Romania; SRB=Serbia; SVK=Slovak Republic; SVN=Slovenia.

**Figure 6. Labor Market Statistics**

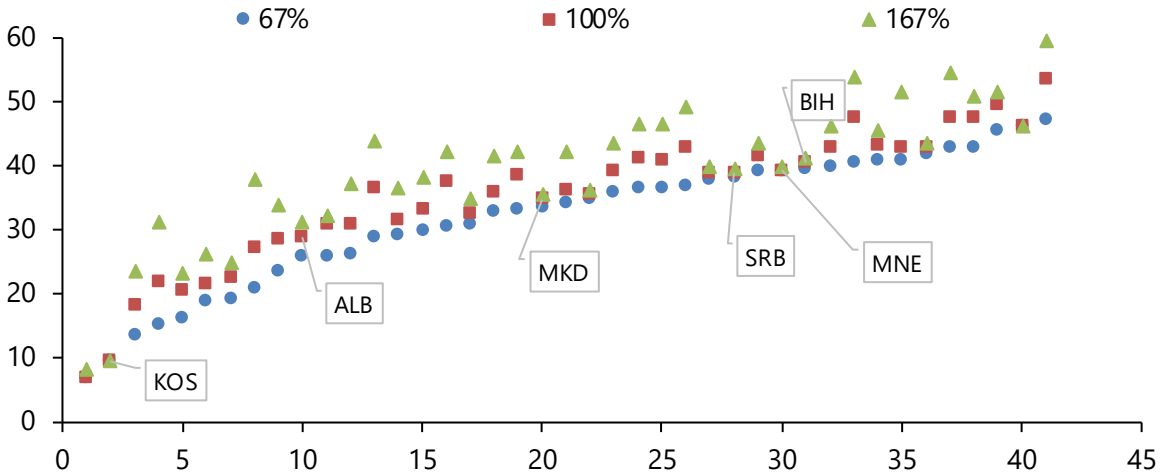
**1. Labor Force Participation Rates (Percent)**



Sources: International Labour Organization (ILO) and IMF staff calculations.

Notes: Labor force participation rate defined as the sum of all persons of working age who are employed and those who are unemployed divided by the working age population.

**2. Labor Tax Wedge by Income Level in SEE (non-EU) and OECD Countries, 2017 (Single person at X percent of the average wage)**



Source: Jankulov Suljagic 2019.

Notes: Tax wedge is defined as the ratio between the amount of taxes paid by an average single worker (a single person without children at 67, 100 and 167 percent of average earnings) and the corresponding total labor cost for the employer.

**Table 2. Albania: Comparing Albania's Tax System with Regional Neighbors**

	PPP GDP per capita (PPP\$)	Nominal GDP per capita (US\$)	Value-added tax (VAT)			Personal income tax (PIT)		Business/Corporate income tax (CIT) 1/			Simplified tax regime	
			Small business threshold (US\$)	Standard rate (percent)	Reduced rates (percent)	Basic income allowance (US\$)	Rates (percent)	General rate (percent)	Reduced CIT rate (percent)	Small companies turnover threshold (US\$)	Rates (percent)	Turnover threshold (US\$)
<b>Albania 2/</b>	<b>13,327</b>	<b>5,239</b>	<b>18,521</b>	<b>20</b>	<b>6</b>	<b>3,334</b>	<b>0, 13, 23</b>	<b>15</b>	<b>5</b>	<b>129,644</b>	<b>0, 5</b>	<b>74,082</b>
<b>Southeastern Europe: EU members</b>	<b>22,853</b>	<b>10,727</b>	<b>47,820</b>	<b>20.7</b>				<b>13.7</b>				
Bulgaria	23,169	9,314	30,205	20	9	..	10	10	..	..	..	..
Croatia	26,256	14,870	47,778	25	5, 13	..	24, 36	18	12	477,781	..	..
Romania 3/	26,448	12,270	76,111	19	5, 10	..	10	16	..	..	1, 3	1,181,490
<b>Southeastern Europe: non-EU countries</b>	<b>15,537</b>	<b>6,455</b>	<b>37,187</b>	<b>18.8</b>				<b>10.8</b>				
Bosnia and Herzegovina	13,583	5,755	30,175	17	..	2,173	10	10	..	..	..	..
Kosovo	11,664	4,433	35,445	18	8	1,134	0, 4, 8, 10	10	..	..	3, 9, 10	59,075
Montenegro	19,172	8,763	21,267	21	7	..	9, 11	9	..	..	..	..
North Macedonia	15,715	6,100	19,188	18	5	1,734	10	10	..	..	0, 1	115,127
Serbia 4/	17,552	7,223	79,860	20	10	1,833	10	15	..	..	..	..
<b>Central and Eastern Europe: EU members</b>	<b>34,627</b>	<b>20,149</b>	<b>49,989</b>	<b>22.6</b>				<b>17.4</b>				
Czechia 5/	37,340	23,113	46,020	21	5, 10	..	15	19	..	..	..	..
Hungary 6/	31,914	16,484	30,648	27	5, 18	..	15	9	..	..	37	114,931
Poland 7/	32,005	15,426	55,379	23	5, 8	Tax credits	18, 32	19	9	332,272	..	..
Slovakia	35,136	19,579	58,826	20	10	..	19, 25	21	..	..	..	..
Slovenia	36,741	26,146	59,075	22	9.5	..	16, 27, 34, 39, 50	19	..	..	..	..

Sources: Commercial sources; International Bureau of Fiscal Documentation; National sources, and IMF staff compilation.

Notes:

1/ In Bulgaria, Czech Republic, Hungary, Montenegro, and Serbia, income earned from self-employment is taxed under the PIT.

2/ In Albania, the tax rate under the simplified regime is applied to profits.

3/ As of Jan 1, 2018, Romania lowered its flat-rate PIT from 16 to 10 percent. Micro-companies (with turnover < RON 1 million) with 0 employees pay 3 percent on turnover, while those with 1 or more employees pay 1 percent.

4/ In Serbia, if an individual earns between 3 times and 6 times the average salary (RSD 823,548 as of 2018), an additional tax rate of 10 percent is applied. For earnings over 6 times the average salary, an additional 15 percent is applied.

5/ As of 2013, a solidarity contribution of 7 percent of income above the social contributions cap (48 times the average monthly wage per year, currently CZK 1,569,552 for 2019) was introduced.

6/ Hungary has two small business tax regimes: (i) Simplified entrepreneurial tax (EVA) is paid in lieu of PIT, social contributions, and VAT, which is reported in the table; (ii) Fixed-rate tax for low tax-bracket enterprises (KATA) for enterprises with income below HUF 6,000,000 (US\$ 22,986) of HUF 50,000 per full-time business member.

7/ Tax credits are applicable on a reducing basis for taxable incomes up to PLN 127,000 (US\$ 35,166) based on a formula. From Aug 1, 2019, all employees in Poland under the age of 26 years are exempt from paying personal income tax.

### III. CONSUMPTION TAXES

#### A. Value-Added Tax

##### Current System

**23. The VAT is the most important revenue source of Albania providing 8.8 percent of GDP, and 47 percent of tax revenues and 37 percent of total tax and social security contribution revenues (Table 3).** Albania has a broad-based VAT that is broadly aligned with the EU VAT Directive. The current law entered into force in 2015 and has already been amended five times since then, adding new exemptions and reduced rate activities.

**Table 3. VAT Revenues, 2017-2019**

	ALL million			(in % of Total tax revenues)		
	2017	2018	2019 (9 month)	2017	2018	2019 (9 month)
Import VAT	104,586	107,157	79,405	35.6	35.2	34.3
Gross domestic VAT	48,845	50,763	35,815	16.6	16.7	15.5
Refunds	13,891	14,394	14,502	4.7	4.7	6.3
Total net VAT Collection	139,540	143,526	100,718	47.6	47.2	43.5

Source: Albania Ministry of Finance.

**24. The general VAT registration threshold is set at an annual turnover of ALL 2 million (before April 2018 it was ALL 5 million) with two important exceptions.** Professionals, such as lawyers, notaries, doctors, architects, and auditors, are required to register and their services are taxed irrespective of the threshold. Agricultural producers that carry out their activity as individual farmers are only required to register if their turnover is above ALL 5 million. Voluntary registration of any taxpayer is possible.

**25. Albania has a standard VAT rate of 20 percent and a reduced rate of 6 percent.** The standard rate applies to most goods and services, while the reduced rate is applied to accommodations services provided by hotels and other similar establishments; accommodation and restaurant services by registered agrotourism providers; advertising in electronic media, and the supply of books (previously exempt).

**26. Zero rates apply to exports and a standard set of goods and services, as well as to temporary imports of certain goods.** Zero rates apply on the importation of goods to free zones and fiscal or customs warehouses, and on so-called "linked services" that are services supplies linked to the supply of goods in these free zones (Box 2).

## Box 2. Tax Free Zones

Albania has several provisions to exempt taxpayers operating in special zones from indirect taxes and/or customs duties, such as bonded warehouses, production warehouses, tax suspension regimes, and special economic zones. There is a total of 670 entities with special provisions, of which 13 are bonded warehouses, 27 are production warehouses, and 183 are fishing operators with suspension regimes. No company has been registered to operate in special economic zones so far.

Special tax zones are usually established to alleviate the administrative burden on producers of exported goods or temporary importers. Many countries establish special tax zones to stimulate investment and employment. To the extent that these rules are only applied to exporters that do not interact with domestic taxpayers, special tax zones are mostly a tax administration concern. Adequate controls need to be in place to ensure that goods and services sold by firms operating in special zones to the domestic market bear appropriate tax burden, including indirect taxes.

However, there is an incentive for enterprises to arrange their affairs so that revenues are declared inside the special zone and expenses declared in an operation outside the special zone, to minimize the aggregate tax burden. To control these adequately is administratively difficult. Furthermore, if the interaction between firms inside and outside the special zone puts additional burden on suppliers, e.g., because of VAT refund problems, there is pressure on the government to extend the benefits to domestic suppliers to these zones. This has been the case in Albania, leading to a gradual creep of beneficial treatments radiating out along the value chain beyond the special zones.

Since administration of special tax zones, such as warehouses in case of Albania, is difficult, their use should be very limited. If the establishment of a free zone cannot be avoided, their potential negative effects should be strictly limited: (1) the free zone should be physically isolated and effectively controlled; (2) privileges should be strictly limited to those directly related to a liberal trade tax regime, i.e., trade taxes, with no incentives provided for direct taxes or property taxes, and no benefit to taxpayers operating outside the zone.

**27. The VAT Law provides a broad range of exemptions along three classes: (a) exemptions for certain public interest transactions; (b) exemptions for other activities, and (c) exemption on importation.** Class (a) includes most public services, such as healthcare, education (public and private instruction), medicines, social and religious services, sports, non-profit and cultural organizations, postal services, and broadcasting. The most recent amendment to this category added exemptions on agricultural machines, agricultural inputs, and veterinary services. Class (b) includes many commercial supplies, for example, financial services, insurance, gambling, supplies of buildings, transactions and leasing of immovable property, newspapers, advertisements in print media, and hydrocarbon operations. Finally, class (c) includes unconditional exemptions of imports of many items, for example, used personal items, inheritances, etc., and conditional exemptions on a list of items such as, for example, machinery and equipment for large investment projects, investments in the processing and agri-business sector, and machinery and equipment; goods and services for implementation phase of hydrocarbon research; and agricultural machines.

**28. The VAT Law provides special regimes for certain groups of taxpayers, the most important of these being farmers.** As mentioned above, the registration threshold for farmers

is 2.5 times higher than that for all other taxpayers at ALL 5 million. Furthermore, farmers are entitled to a flat-rate compensation scheme. Eligible entities to this scheme include those that are engaged in activities in the agricultural, forestry, and fisheries sectors and whose annual turnover is below the higher threshold. The current compensation rate is 6 percent, reduced from 20 percent last year. If the eligible farmer makes supplies to a taxable customer, the taxable customer must pay the farmer 6 percent compensation calculated on the VAT-exclusive price of the good, to compensate the farmer for input VAT. The taxable purchaser can then declare the purchase as a deductible input and claim the 6 percent compensation as an input VAT credit.

## **Reform Proposals**

**29. The Albanian authorities estimate the revenue loss due to VAT exemptions around 5.4 percent of GDP.** The authorities prepared a draft tax expenditure report that takes stock of the cost of VAT exemptions, although this estimate also includes the revenue loss due to non-compliance and tax evasion. The sectors with the largest revenue forgone are public administration, real estate services, education services, and human health services (0.84, 0.74, 0.71, and 0.64 percent of GDP respectively). Other sectors with substantial tax expenditures are food, beverage, and tobacco; textile, clothing, and leather; other household services; and art, entertainment, and recreation. These eight sectors together account for about 4.5 percent of GDP loss in VAT revenues, suggesting substantial scope to improve collection by improving both VAT policy and compliance.

### ***Proposals to Enhance the VAT Base***

**30. A large share of revenue forgone is due to exemptions on a broad set of final consumer goods.** Exemptions should be eliminated on the following goods and services to mobilize revenues:

- **Health and education services provided by the private sector should be taxable by VAT.** VAT exemptions and zero rating are very poorly targeted, and therefore expensive ways of providing assistance to vulnerable groups. Furthermore customers of private sector health and education services tend to be better off and consume more. As a result, a larger share of the VAT exemption is received by wealthier households than by poor households, making this benefit regressive by income.
- **Non-prescription drugs, medicines and related products should be taxable, preferably at the standard rate.** General exemptions of drugs and medicines typically benefit the wealthy households more than the poor and are easy to abuse. All non-prescription drugs, over-the-counter drugs, drugs ordered online, and related products such as food supplements and vitamins, should be subject to VAT, and only the supplies of drugs prescribed by a licensed healthcare professional and not available over-the-counter should remain exempt. Definitional problems require special attention and careful legislation. If the

impact on poor households is a concern, they should be compensated through the benefit system where the targeting can be more accurate.

- **Insurance (other than life insurance) is subject to a 10 percent premium tax**, but all fee-based financial services should be taxed at the standard VAT rate. In the longer term the tax treatment of these types of financial services and insurance can be unified under the VAT.
- **The first sale of new residential property should be subject to VAT, but subsequent sales of residential property and long-term rentals and leases should remain exempt**, because the first selling price comprises the present value of all future returns on the investment. Commercial transactions of property (sale, leasing or rental) should be subject to VAT that can be credited by businesses. The system works best if all construction inputs and services are taxable, so that the VAT chain is not broken by exemptions, and therefore inputs are creditable.

**31. Estimating the revenue impact of eliminating VAT exemptions is very difficult when many exemptions fragment the tax system** (see Box 3). Estimating the revenue cost sector by sector shows that about 1.3, 0.4, 0.2, and 0.1 percent of GDP is forgone in the financial services, construction, health and education sectors respectively. However, when simulating the overall impact of total exemptions using microdata, the simulation results show that eliminating all exemptions might not significantly raise VAT revenues. The indirect impact would be very important however, by making the VAT more transparent and much easier to administer and collect.

### **Box 3. Revenue Impact of VAT Exemptions**

VAT exemptions have many effects. They distort revenues by cascading the tax on inputs. They distort input choices: the unrecovered taxation of some intermediate inputs that is implied by exemption will induce producers to substitute away from those inputs. Because cascading means higher tax payment, they create incentives for companies to vertically integrate to avoid stages of taxation. They compromise the destination principle of VAT: exports would be zero rated, but it is not possible to remove the consequences of an exemption at an earlier stage of production. They lead to “exemptions creep”: having one exemption creates pressures for exemptions for commodities used to produce that exempted item. They lead to avoidance and misreporting of activities as exempt.

The revenue impact of exemptions is particularly complex, and exemptions can both lead to fall or increase of VAT revenues. Exemption breaks the VAT chain. Whether this increases or decreases the net revenue raised by the VAT depends where in the chain of supply the break occurs. If the exemption occurs immediately prior to final sale, the consequence is a loss of revenue since value added at the final stage escapes tax. If the exemption occurs at some intermediate stage, on the other hand, the consequence is actually an increase in net revenues: the cascading of tax on inputs means that, as the price charged by downstream firms using the exempt item rises in order to cover their increased costs, so the tax on output downstream increases. Thus, value added prior to the exempt stage is effectively taxed more than once.

Source: Ebrill et al, 2001, The Modern VAT.

**32. The reduced VAT rate of 6 percent on tourism-related activities should be eliminated.** Accommodation services should be taxed with the standard rate instead of the reduced rate (Box 4). The reduced rate applies to all services offered by 5-star hotels, and to accommodation services only in case of other accommodation providers. This type of inequity is undesirable. Furthermore, the VAT treatment is unclear in the case of composite services, such as when room cleaning service is included in the price of a room. Reduced VAT rates are usually ineffective at stimulating demand for tourism as experience suggests that hotel operators increase pre-tax prices to leave the tax-inclusive price unchanged, and they do not pass the savings to consumers. From an international tax policy perspective, it makes little sense to forgo tax revenues on an imported tax base that is not very price sensitive. Other activities taxed with the reduced rate were granted this special treatment mostly to address tax administration issues. Raising the reduce rate to the standard rate would increase revenues by about 0.1 percent of GDP.

#### **Box 4. VAT and Tourism**

Many countries, including in the region, aim to facilitate tourism and high-end (elite) tourism by providing reduced VAT rates or exemptions to the hotel and accommodation sector. These benefits should be carefully evaluated through cost-benefit analysis to assess their efficiency and effectiveness.

If tourist demand is price-elastic, for example, because locations in different countries are close substitutes, tax rates might matter through the impact on consumer prices. However, the impact of VAT on consumer prices is also a function of pass-through: whether service providers pass on the lower VAT rate as lower prices or not. This might not always be the case as service providers might maintain prices and absorb the tax savings as additional profits.

Multiple VAT rates however complicate administration and compliance and create opportunities for abuse. Moreover, VAT on hotel accommodation is largely a tax that bears on foreigners, not on citizens. Tourism demand may also be less price-sensitive if a country offers a unique tourist facility that cannot be easily substituted for, and high-end tourism is typically less price-elastic than other segments. Whether job creation in the tourism sector is a compelling argument for a reduced VAT rate that forgoes tax revenues, depends on its effectiveness compared to alternative instruments of employment creation, such as cutting other taxes, or spending funds on labor market policy.

Overall, the case for a reduced VAT rate on hotel accommodation depends on country specific circumstances. Specifically, it will depend on the elasticity of demand, the costs of administration and compliance, rate differentiation, the opportunities for abuse, the share of accommodations consumed by foreigners and the extent to which a country values the welfare of these foreigners. Moreover, it also depends on the relative prices compared to neighboring countries. In many cases, the balance will offer little grounds for applying a reduced VAT rate.

**33. Tax policy changes have often been introduced to address lobby interests or problems with VAT refunds and these measures should be eliminated.** Several exemptions on inputs have been introduced to preempt the net VAT credit position of taxpayers. However,

these exemptions break the VAT chain making enforcement more difficult and also lead to cascading of the VAT burden if applied in the middle of the supply chain. All exemptions should be carefully reviewed and those without a sound justification should be eliminated. Tax administration problems should not be addressed by tax policy changes in the future and the VAT system should be simple and transparent to ease compliance and enforcement.

**34. Zero rating of certain activities was also introduced—similar to the rationale for the exemptions mentioned above—to address tax administration issues.** For example, the zero rating on linked services to warehouses is unnecessary and should be eliminated. The number of fiscal warehouses and suspension regimes should be reduced to enable easier monitoring and enforcement.

**35. The VAT system, together with income taxes and other taxes, provides many benefits to certain groups of taxpayers (see Box 1) that undermine the efficiency and integrity of the tax system.** These benefits should be assessed, evaluated and phased out. It is more transparent to provide direct subsidies to priority sectors, and therefore much easier to control.

#### *Proposals to Strengthen the Quality of the VAT*

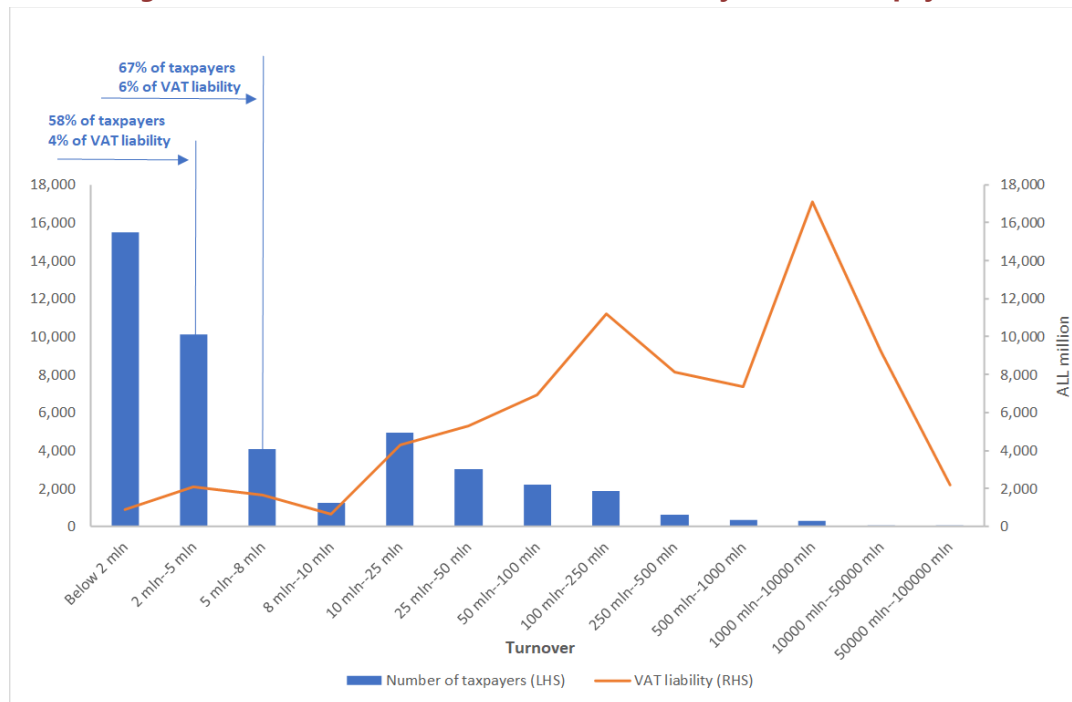
**36. To support the fight against informality, Albania reduced the VAT threshold from ALL 5 million to ALL 2 million last year.** This increased the number of VAT taxpayers from 38,000 to 53,000. At the same time the capacities of the tax administration have not been increased, and therefore the monitoring of small registered taxpayers has not been catching up. However, reductions in informal activity and formalization will not result from mandatory registration, but instead from economic development, administrative improvements, and greater trust in the tax system.

**37. Registering micro and small businesses for VAT puts an enormous burden on the tax administration without raising much revenues.** When administrative capacity and compliance are low, as is the case in Albania, the threshold should be relatively high. Small taxpayers below the threshold pay VAT on all their intermediary inputs without the opportunity to claim input tax credits, thus they pay VAT at the standard rate on inputs and contribute to revenues. Albania's threshold in relation to the region was broadly comparable at ALL 5 million, and very low at the current ALL 2 million.

**38. Distribution data on the turnover and VAT payment of taxpayers demonstrates the impact of the threshold on VAT revenues.** Figure 7 illustrates two common empirical regularities well. First, there are strongly diminishing returns to collections when the threshold is reduced. Second, about 94 percent of VAT collections come from about 33 percent of businesses. Higher VAT thresholds allow the administration to focus on the medium and large businesses that collect and remit the bulk of VAT revenues. A higher VAT threshold still raises revenue from non-registered taxpayers by VAT on their purchased inputs. But this impact

critically hinges on making business inputs taxable rather than exempt. If inputs are exempt or zero-rated than the revenue from the VAT on the inputs of small suppliers is lost. Registration should not be allowed for the smallest taxpayers, because voluntary registration for all taxpayers often leads to fraudulent VAT refund claims that are very costly to monitor and audit.

**Figure 7. Distribution of Turnover and VAT Payment of Taxpayers**



Sources: Albania Ministry of Finance IMF staff calculations.

**39. Mandatory registration of professional service providers is inconsistent with the proper application of the threshold and leads to tax avoidance.** Professionals are required to register so that VAT could be collected on their turnover in lieu of the under-reporting and under-taxation in the simplified profits tax regime (see Section IV). In order to avoid disputes and prevent avoidance, it is preferable to apply the threshold consistently to all businesses.

**40. The VAT threshold should be raised to ALL 8 million, with voluntary registration allowed between ALL 5 million and ALL 8 million, but not below.** Voluntary registration can be useful for small businesses that expect to cross the threshold within a few years and wish to claim credit for input VAT (and charge VAT to their customers). Unregistered businesses can also be in a disadvantaged position relative to large businesses operating in the same sector, because unregistered businesses are not entitled to VAT refunds on their inputs. However, the prevalence of fraudulent invoices suggests that voluntary registration could lead to overuse of this provision. To help limit fraud in the system and contain administrative costs, voluntary registration should be limited. The threshold should also be applied consistently across all taxpayers, regardless of their activity. Professionals should be taxed on their income in the PIT (see Section IV).

**41. The compensation scheme should be phased out over time and be replaced with targeted benefits for the agriculture sector that are much easier to control and monitor.**

Farmers and agricultural producers receive many benefits through the tax system, including a flat-rate compensation scheme for input VAT at 6 percent of sales (previously 20 percent) paid by the purchaser. The compensation is irrespective of actual input VAT and works as a subsidy. Under the normal VAT regime, higher costs mean higher VAT on inputs, but under the scheme that effect is absent. Furthermore, the actual pass through of the subsidy to farmers by their purchasers is unknown. It was suspected by policymakers that purchasers did not pass on the 20 percent compensation to farmers in full and, therefore, the compensation rate was reduced to 6 percent. It is worth noting that most agricultural inputs are exempt from VAT and voluntary registration allows farmers whose actual input VAT is higher than 6 percent to register and claim refunds. Therefore, the compensation scheme seems generous even at 6 percent, while it also leads to high leakage through the less than full pass through by agricultural purchasers.

## **B. Excises**

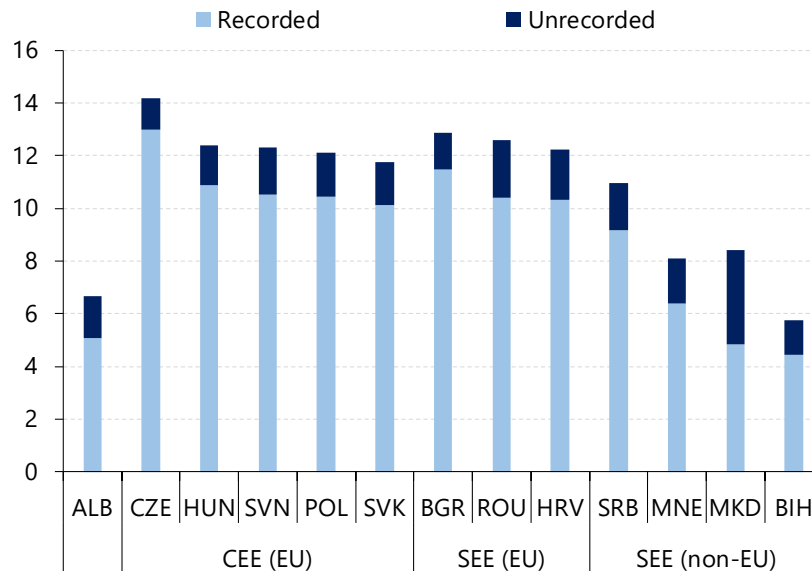
### **Current System**

**42. Albania has a comprehensive set of excises mostly harmonized with the EU directive.** Excise duties are payable on certain goods imported into or produced in Albania, including alcoholic beverages (beer, wine, spirits, etc.), tobacco products, petroleum byproducts, coffee, batteries, fireworks, and tires. Excises raise around 15 percent of tax revenues, that is in line with other countries in the region. About 55 percent of excise revenues is from fuel products, 35 percent from tobacco products, and the remaining 10 percent from the other categories of goods. According to the authorities' tax expenditure report the estimated tax expenditures on diesel, gasoline, tobacco, beer and wine amount to around 0.08 percent of GDP, or 4.4 percent of excise revenues. Albania applies specific excises to alcohol and tobacco products and have a predetermined calendar of gradual excise rate adjustment for tobacco until 2020.

### **Reform Proposals**

**43. Alcohol excises deliver a very small share of total excise revenues.** Albania has a high threshold for exemption on own production for family consumption: 200 liters of wine and 100 liters of Raki per year per family. This type of production is not controlled, and therefore can lead to leakage, sales on the informal market or smuggling. By contributing little to excise revenues, alcoholic beverages are a relatively under-utilized tax policy lever. Therefore, the high level of alcohol for own consumption should be reviewed and enforced. While Albania's alcohol consumption is one of the lowest in the region (Figure 8), it could be useful over the medium term to determine whether alcoholic beverages could prove to be a more productive revenue source.

**Figure 8. Alcohol Consumption per Capita (ages 15+ years),  
Liters of Pure Alcohol**



Sources: WHO Global Health Observatory and IMF staff calculations.

**44. A further loophole in the regulation is the reduced specific excise rate on alcohol imported from or produced by small manufacturers.** Beer excise for small producers is about half and wine excise for small producers is about a third of the regular excise rate. As a result, policymakers reported that almost all imported alcohol is reportedly from foreign small-scale producers. This differentiated rate should be eliminated, and all excises should be set at the regular level, both for beer and wine.

**45. Fishing vessels are exempt from excise on fuel that leads to a loss of revenue and should be eliminated.** Support to any sectors or groups of taxpayers should be provided through direct subsidies rather than tax exemptions. Exempting fuel for fishing can lead to revenue leakage and abuse of the provision.

**46. Heating oil and fuel consumed in heated greenhouses get a refund for fuel excise that should be revised and possibly eliminated.** On the other hand, the circulation tax (discussed below) is paid on the fuel used for these purposes. Exempting fuel that is not used for transportation from circulation tax can be justifiable, but fuel excise should be paid on all fuel used in the domestic economy.

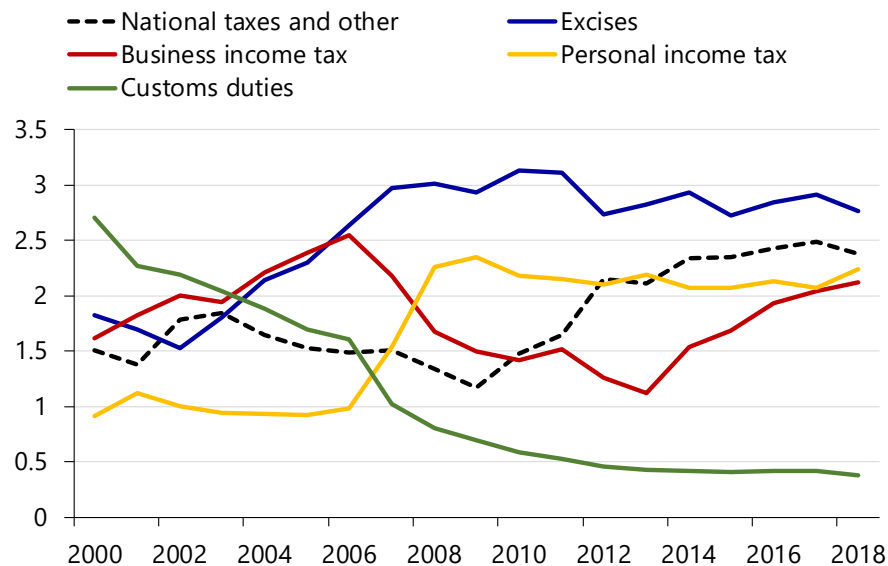
**47. For administrative reasons the authorities have moved away from ad valorem excises and have specific excises on most products, that do not automatically guarantee that excise levels keep up with price increase.** Specific excise rates need to be updated on a regular basis to prevent erosion, and therefore the authorities should introduce an automatic indexation of excise rates.

## C. Environmental Taxes and Other National Taxes

### Current System

**48. Albania imposes several other taxes, called national taxes, many of which are essentially additional forms of excise duties and contribute a non-negligible amount of revenue for the budget.** The legislation lists 11 national taxes, which together contributed about 2.5 percent of GDP in 2018 (12 percent of total tax revenues). The importance of these taxes has grown over time and as of 2018, national taxes contributed the third highest level of tax revenues (after VAT and excise duties) more than other taxes such as the business profits tax, the personal income tax (Figure 9).

**Figure 9. Comparing Revenues from National Taxes, in Percent of GDP**



Sources: GDT and IMF staff calculations.

**49. Out of the national taxes, the most important are:** (i) vehicle taxes (circulation tax, carbon tax, annual tax on used vehicles, tax on luxury cars, and a registration tax on non-luxury cars); (ii) tax on plastic packaging; (iii) mineral royalty, and (iv) tax on insurance premiums. Some of these taxes (e.g. circulation tax and carbon tax) are incorporated in the pump price of fuel and are very similar to fuel excises, but administered and collected by a different agency, making administration complicated.

**50. Several of the national taxes on certain products aim to compensate for their degrading impact on the environment:** (i) The circulation tax on petroleum and gasoline is ALL 27/liter, (ii) the carbon tax is set at ALL 1.5/ liter of petrol; ALL 3/liter of gasoline, kerosene, solar, fuel oils, mazut; ALL 3/kg of coal, and ALL 3 /kg of petroleum coke; and (iii) packaging tax on plastic and glass with tax rates between ALL 5–35/kg depending on the material and composition of the packaging. The packaging tax has been reduced from last year due to pressures from

domestic producer groups. Furthermore, the environmental tax on lightbulbs has been eliminated.

## Reform Proposals

**51. Several exemptions are granted from national taxes, partly to favor priority sectors and partly to address tax administration issues.** For example, agricultural machines are exempt from the annual tax on used vehicles and fishing boats are exempt from the carbon tax. All exemptions should be revised and eliminated. Priority sectors should be supported through direct transfers that are easier to monitor and contain, without undermining the integrity of the tax system.

**52. The regulation on the packaging tax is very complex with several tax rates, and all rates are very low.** Considering Albania's aspiration to become a high-end tourism destination it would be especially important to provide the right incentives to keep the environment clean and higher plastic bag and bottle waste levies could support these efforts. Previous missions estimated the potential revenue from increasing the specific charges payable on plastic bags, plastic bottles to 5–10 EUR/kg—as well as introducing charges on aluminum cans—at around 0.2–0.5 percent of GDP. Supporting regulation to help with the implementation was also discussed at length in the December 2017 Tax Policy TA report.

## IV. A COMPREHENSIVE APPROACH TO TAX INCOME

### A. Current System

**53. The Albanian economy is characterized by a high level of informality, which undermines the tax base and revenue mobilization.** As noted earlier, the labor tax wedge measures the extent to which tax on labor income discourages employment. In this way, labor taxes on income generate income and substitution effects as they influence the share of gross income that workers take home. As such, they have the potential to influence at the margin whether an individual will choose to work (the “extensive” margin) or work more (the “intensive” margin). For example, a large wedge can therefore encourage informality by making the marginal cost of formalization prohibitively high.

**54. The overall taxation of labor—and the impact of the resulting labor tax wedge on efficiency, equity, and neutrality—is of significant policy interest for Albania for two reasons.** First, as highlighted in Section II, labor taxes, which include social contributions and personal income taxes are important revenue sources for Albania. Second, labor taxes can have a substantial impact on economic activity, through their behavioral implications for labor market efficiency, equity, and neutrality. Like many countries, the Albanian government has prioritized progressivity when it comes to the design of their direct income taxes. As a result, in 2014, the

personal income tax was changed from a 10 percent flat rate to a progressive structure with three rates. As of 2018, the first ALL 360,000 of annual income is taxed at 0 percent; income between ALL 360,000 up to ALL 1.8 million is taxed at 13 percent, and any income over ALL 1.8 million is taxed at 23 percent.

**55. Both personal income taxes and social contributions contribute to the labor tax wedge.** Social security and health insurance contributions are compulsory for employees and self-employed and nondeductible for income tax purposes. There is both a minimum payment required based on a minimum monthly income (ALL 26,000, as of 2018), as well as a cap to contributions based on an upper bound of monthly income (ALL 114,670, as of 2018). Full gross income serves as the base for health insurance contributions. Employees are required to make social security contributions at a rate of 9.5 percent and health insurance contributions at a rate of 1.7 percent. As such, the effective rate of social contribution is a declining share for earnings over the cap. Employers must supplement employees' contribution over the same base with 15 percent for social security and 1.7 percent for health insurance. The self-employed pay contributions that proxy the sum of employer and employee contributions at rate of 23 percent for social security and 3.4 percent for health insurance. The upper and lower limit of social security contributions for self-employed—at ALL 26,000 and ALL 114,670 respectively—are identical to that for employees, however, the base for health insurance is different and stands at the double of minimum wage (currently ALL 52,000). As for other taxes, the agriculture sector has a special carve-out: social contributions for self-employed farmers are at a lower fixed amount, which depends on the geographical location of the business (highlands vs. lowlands).

**56. Social benefits and their link to taxation also influence labor supply.** For labor supply purposes, the specific legal instrument causing the tax wedge is of little importance: personal income tax, wage taxes and social insurance contributions. What matters is the degree to which these taxes or contributions are (dis-) joined from possible (social security) benefits. For example, if benefit or spending entitlement are linked to a status of contributing, joining the labor force may have a value that would reduce the effective tax wedge at the extensive margin. Similarly, pension benefits with a strong contributions link can influence both the extensive and intensive margins.

**57. Alongside the PIT, Albania's business tax regime also has a "progressive" structure and differentiates between businesses by both size—measured by turnover—and sector.** With the introduction of the "simplified profits tax" in 2014, the business tax regime has been characterized by separate treatment for the profits of small and medium-sized enterprises (SMEs) and large businesses. Prior to that, businesses were subject to a uniform 10 percent flat rate business profits tax, which matched the previous flat rate under the PIT. After 2014, businesses were segmented by turnover (not profits) and those with turnovers less than ALL 8 million came under the SPT: those with turnover between ALL 2–8 million were taxed at a rate of 7.5 percent on their profits, while the smallest businesses with turnover less than ALL 2 million were subject

to a flat fee of ALL 25,000. Businesses with turnover greater than ALL 8 million were taxed at 15 percent.

**58. Changes to the business tax regime in 2016 and 2018 have seen even more preferential size-based tax incentives entering the system.** The SPT was modified in 2016 to relieve all small businesses with turnovers below ALL 5 million of any tax liabilities (by setting a 0 percent rate), while the profits of businesses with turnover between ALL 5–8 million became subject to a tax rate of 5 percent. This size-based preferential treatment extended also to the general regime from January 1, 2019, where the profits of businesses with a turnover between ALL 5–14 million are now subject to a reduced rate of 5 percent, while only those with turnover greater than ALL 14 million have their profits taxed at a rate of 15 percent. Dividends or profit distributions are taxed at 8 percent as of January 1, 2019 (previously 15 percent), in an attempt to reduce the tax burden on owner-directors and employees.<sup>5</sup>

**59. Additional sector-specific tax incentives have also been embedded into the business profits tax system by extending reduced business tax rates to certain sectors.** These include a reduced profit tax rate of 5 percent for: (i) IT software development businesses; (ii) agricultural cooperatives, and (iii) businesses that have been awarded agrotourism status (applicable for a 10-year period). Internationally-recognized 4-/5-star hotels (that qualify before Dec 2024) are also fully exempted from the business profits tax for a period of up to 10 years.

**60. The business tax system in Albania does not distinguish between incorporated and unincorporated businesses.** Self-employed individuals—also referred to as sole traders or entrepreneurs—must register as individuals with the commercial register for tax purposes. This registration does not infer the establishment of a separate legal entity—the person, sole trader, preserves their status as an individual, natural person—but instead gains the individual the ability to be party to commercial relations. Depending on the level of their declared turnover, they are taxed under the SPT or the general business profits tax regime, but not the personal income tax.

**61. The current tax system also allows individuals to reduce their tax liability by altering their mode of engagement (e.g., as a self-employed business or employee).** The complex set of thresholds and rates under the business profits tax—namely the zero and reduced rates under the SPT—interacts with the progressive PIT structure to distort the choice of how individuals work. In other words, the tax system is no longer neutral between forms of business activity. For example, individuals are incentivized to minimize their tax burden by reorganizing themselves into self-employed small businesses and offer their (professional) services to larger businesses as contractors rather than come on the payroll as employees. In this way, an individual earning ALL 5 million in annual (net) income can face an effective income tax

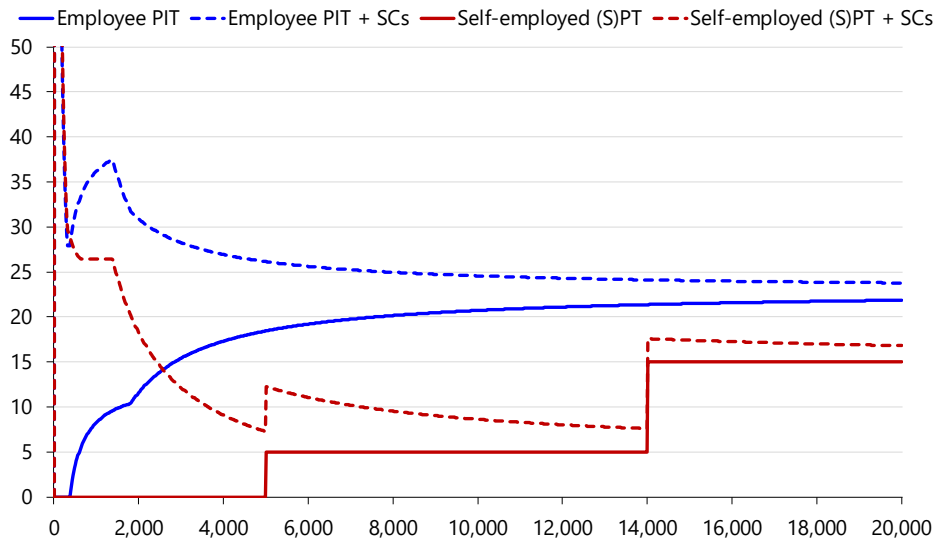
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<sup>5</sup> The rate of 8 percent will also apply for earnings realized in 2018 or retained earnings of prior periods, including the reserves and retained earnings transferred to registered capital, provided that: (i) the tax on dividends or profit distributions deriving from retained earnings of 2017 or earlier periods is paid before Sep 30, 2019; (ii) the tax on dividends or profit distributions deriving from earnings of 2018 is paid by Aug 20, 2019.

rate of 0 percent in self-employment under the SPT, instead of 18.5 percent as an employee under the PIT (Figure 10). Even though social contributions help narrow the gap between the effective tax burdens of employees and the self-employed, it remains sizeable, averaging around 15 percentage points for incomes between ALL 5 million and ALL 14 million.

**Figure 10. Effective Tax Burden: Employee vs. Self-Employed**

(Y-axis: percent; X-axis: ALL 000s)



Sources: IMF staff calculations.

Notes: PIT=personal income tax; (S)PT=(simplified) profits tax; SCs=social contributions. The effective tax burden for employees comprises personal income taxes and employee and employer social contributions. For the self-employed, the tax burden comprises (simplified) profits taxes and a separate rate of self-employed social contributions. Given minimum compulsory social contributions, the effective tax rate theoretically peaks at 8,704,800 percent and 9,297,600 percent for ALL 1 of earnings for employees and the self-employed, respectively.

**62. Tax revenues from the SPT amounted to less than 0.03 percent of GDP in 2018, despite declared turnover from businesses under the scheme totaling 8.4 percent of GDP (Table 4).** Within the current SPT, over 90 percent of taxpayers are physical persons that account for about 90 percent of all turnover reported. Of these physical persons, 50 percent are in the services sector and 35 percent in the trade sector. Data from the GDT suggests that turnover from those physical persons in professional services (including accountants, architects, business consultants, computer programmers, dentists, engineers, medical professionals, and lawyers) amounted to just under 10 percent of total declared turnover under the SPT (0.83 percent of GDP), and that these individuals make up approximately 7 percent of the SPT taxpayer base. These professional services also account for over 25 percent of any revenues earned from the SPT (<0.01 percent of GDP). A larger share of recorded turnover (35 percent) comes from 40 percent of the small businesses in the SPT operating in the relatively low-skilled service sectors—auto-repair, beauty, catering, retail, transport, and hotel services. Furthermore, 95 percent of taxpayers under the SPT file revenues less than ALL 5 million and it is unclear whether these incomes have been underreported.

**Table 4. Albania: Breakdown of Businesses Within the Simplified Profits Tax Regime**

	Branches of foreign companies	Joint stock companies	Limited liability companies	Physical persons	Agricultural cooperatives	Other	All legal forms
<b>1. Number of businesses</b>							
Construction	18	1	476	1,516		1	<b>2,012</b>
Manufacturing	9	5	845	7,851	28	7	<b>8,745</b>
Services	38	22	3,908	45,641	2	45	<b>49,656</b>
Trade	9	6	1,610	32,131	10	1,312	<b>35,078</b>
Transport	3	1	461	4,562			<b>5,027</b>
Unspecified				10			<b>10</b>
<b>Total</b>	<b>77</b>	<b>35</b>	<b>7,300</b>	<b>91,711</b>	<b>40</b>	<b>1,365</b>	<b>100,528</b>
<b>2. Declared turnover (percent of GDP)</b>							
Construction	0.00	0.00	0.07	0.15	0.00	0.00	<b>0.22</b>
Manufacturing	0.00	0.00	0.10	0.70	0.00	0.00	<b>0.80</b>
Services	0.01	0.00	0.51	3.41	0.00	0.00	<b>3.93</b>
Trade	0.00	0.00	0.25	2.80	0.00	0.03	<b>3.08</b>
Transport	0.00	0.00	0.05	0.28	0.00	0.00	<b>0.33</b>
Unspecified	0.00	0.00	0.00	0.00	0.00	0.00	<b>0.00</b>
<b>Total</b>	<b>0.01</b>	<b>0.00</b>	<b>0.98</b>	<b>7.35</b>	<b>0.00</b>	<b>0.03</b>	<b>8.37</b>
<b>3. Taxes paid (percent of GDP)</b>							
Construction	..	..	0.001	0.001	..	..	<b>0.001</b>
Manufacturing	..	..	0.001	0.001	0.000	0.000	<b>0.002</b>
Services	0.000	0.000	0.004	0.014	..	..	<b>0.018</b>
Trade	..	..	0.001	0.003	..	..	<b>0.004</b>
Transport	0.000	..	0.000	0.001	..	..	<b>0.001</b>
Unspecified	..	..	..	0.000	..	..	<b>0.000</b>
<b>Total</b>	<b>0.000</b>	<b>0.000</b>	<b>0.007</b>	<b>0.019</b>	<b>0.000</b>	<b>0.000</b>	<b>0.026</b>

Sources: GDT and IMF staff calculations.

**63. Size-related tax and labor regulations can affect firm productivity and growth by lowering efficiency of resource allocation and reducing incentives to invest in innovation.**

Specifically, size-based tax preferences can result in a “small business trap,” creating disincentives for more productive firms to report their income correctly or grow beyond a certain size—typically the small business tax threshold—and lose the benefits of tax preferences. This prevents them from achieving economies of scale, limiting opportunities for future growth (Benedek et al. 2017). At the same time, market development can be hampered as investors would be satisfied with lower gross return on their investment due to the tax preference. This implies that resources would be diverted towards less productive firms and their aggregate share would be larger in equilibrium. Finally, the high share of small and less productive firms that benefit from size-based tax preferences can also result in unfair competition, reducing other firms’ incentives to innovate, lowering in turn aggregate productivity growth (Aghion 2005, and Bobbio 2016).

**64. Filing requirements under the SPT are less stringent than in the general regime but still require substantial official record-keeping obligations.**

Businesses under the SPT are required to keep extensive documentation. For every sale made, they must: (i) issue a simple tax invoice for every taxable buyer who receives the supply, and (ii) issue a tax voucher from the

fiscal cash register for every buyer, individual final consumer. For every purchase, they are obliged to obtain; (i) the VAT tax invoice, when the purchase is made from VAT-registered persons, and (ii) the simplified tax bill, when the purchase is made from persons registered as taxpayers under the simplified profits tax and are not registered for VAT. They are also obliged to maintain: (i) a register of sales, with a record of every sale made using a simplified and regular tax bill; (ii) the register of purchases, with a record of every purchase made with a simplified and regular tax bill; (iii) a register of expenditures and revenues, and (iv) a register of business assets.

**65. What Albania needs is a comprehensive tax system covering all taxpayers group with fair rules and the right incentives.** There are 2 key dimensions of the current tax system that are distorting the business landscape, introducing non-neutrality and undermining revenues: (i) multiple rates, thresholds, and incentives in the business tax regime (both the SPT and the BPT) mean that there is a complex and differential treatment of businesses by size and sector; (ii) certain types of businesses are able to lower their tax liability by operating within the business tax regime (notably, the SPT) rather than falling under the PIT. In the case of the latter, the current system provides incentives for individuals performing identical economic activities to choose self-employment (under the business profits tax) over employment (under the PIT). Alongside such non-neutrality, the tax system is struggling with a high degree of informality which is encouraged by the high level of complexity and compliance costs. There are also individual entrepreneurs enjoying higher income and wealth who are either under-reporting their incomes or are entirely outside the tax system, undermining the fairness/equity of the system.

**66. Furthermore, the tax authority is unable to build a complete picture of individual taxpayers.** Within the PIT, only resident individuals that realize taxable incomes above ALL 2 million (either within or outside of Albania) must submit an annual individual declaration of income to the GDT. Limited resources and minimal exchange of information also mean that the revenue administration is unable to collect data from third parties (e.g., banks, property registers, etc.) to cross-check information and register those individuals for tax purposes.

**67. The capital gains tax (CGT) in Albania is applied only to gains from the sale of property—the so-called “transfer tax”.** At 15 percent, capital gains tax is applied on the difference between the price of purchase and the sale price of a property, as well as on the gains from the sale of an individual’s principal private residence. Furthermore, after Serbia (at 20 percent), Albania has one the highest tax rates on the gains from property out of regional comparators—regional rates for CGT are 15 percent (Czech Republic); 10 percent (Bosnia and Herzegovina, Bulgaria, and North Macedonia), 9 percent (Montenegro), and 0 percent (Poland, Romania, and Croatia).

**68. CGT is typically applied to the gains from the non-recurring sales of shares, bonds, and precious metals, in addition to property.** However, taxes on the gains from asset disposals other than property in Albania are unified with the taxation of profit and treated like ordinary income. In countries where capital gains on a limited subset of assets (e.g., financial assets and non-residential real property) are subject to special tax treatment, a distinction may be made

between: (i) capital gains realized after a short period of ownership, and (ii) capital gains realized after a longer period of ownership—3 or 5 years. Long-term capital gains are typically taxed at reduced rates so as to prevent speculative asset purchases and are adjusted for inflation since the time of the purchase.

## **B. Reform Proposals**

### **Labor Tax Wedge**

**69. The authorities could consider tweaks to the PIT and social contributions that could help mitigate some of the complexity in the system and alleviate the burden of taxation on labor.** Another dimension which is important to investors when it comes to the relative competitiveness of a location is the relative tax burden on labor. However, at present, the PIT falls largely on a very narrow base of taxpayers—public servants and employees of compliant large businesses. Policymakers also noted that incomes being reported under the PIT are also likely to be lower than actual employee compensation, as wages are disbursed partly in cash to limit the amount of tax that is withheld. Ultimately, these are a combination of administrative and taxpayer trust issues that must be addressed for the PIT to reach its full revenue potential. Nevertheless, the following changes to both the PIT and social contributions in combination could help make the system of labor tax more progressive and less complex, while having a positive or insignificantly negative revenue impact<sup>6</sup>:

- The level of earnings used to determine the minimum social contribution—currently, ALL 26,000 per month—should also be aligned with the personal income exemption under the PIT of ALL 30,000. Preliminary estimates suggest that (with an unchanged cap), this could generate an additional 0.08 percent of GDP of contributions.
- The earnings cap for employee and employer social contributions could be raised from ALL 114,670 per month and aligned with the upper threshold of the PIT—currently ALL 150,000 per month. Preliminary estimates suggest that (with an unchanged minimum) this could generate an additional 0.1 percent of GDP of contributions.
- An additional PIT band could also be introduced between 13 and 23 percent for middle incomes—for example, income earned between ALL 100,000 and ALL 150,000 per month could be taxed at the rate of 18 percent. Preliminary estimates suggest that this could raise additional 0.04 percent of GDP in PIT revenues.

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<sup>6</sup> Micro-simulation models for PIT and social contributions have been developed and have been shared with the authorities for capacity-building purposes.

- To the extent that social contributions are insurance-based, the special (lower) contribution rate for self-employed persons in agriculture should be unified with the general scheme for the self-employed.

## **Business Profits Taxation**

**70. It is important to limit the range of special treatments within the general business profits tax regime and maintain a single uniform rate of 15 percent.** The structure of business taxation needs to be modified to prevent distortions, arbitrage, avoidance, and revenue leakage. While it is important to acknowledge that many countries use fiscal incentives to attract foreign investment, these typically lead to an erosion of the tax base by setting a precedent for discretion and preferential treatment which can very easily proliferate. It would be preferable to consolidate all corporate income tax rates into a single unified standard rate. This would offer investors simplicity, predictability, and certainty, while limiting the opportunity for distortionary and discretionary policymaking in the system, which promotes costly rent-seeking behavior. For this reason, the profits tax should operate with a single 15 percent tax rate for all businesses—with no sectoral differentiation—to shore up revenues, prevent distortions to the allocation of resources across the economy, and eliminate non-neutrality across business form.

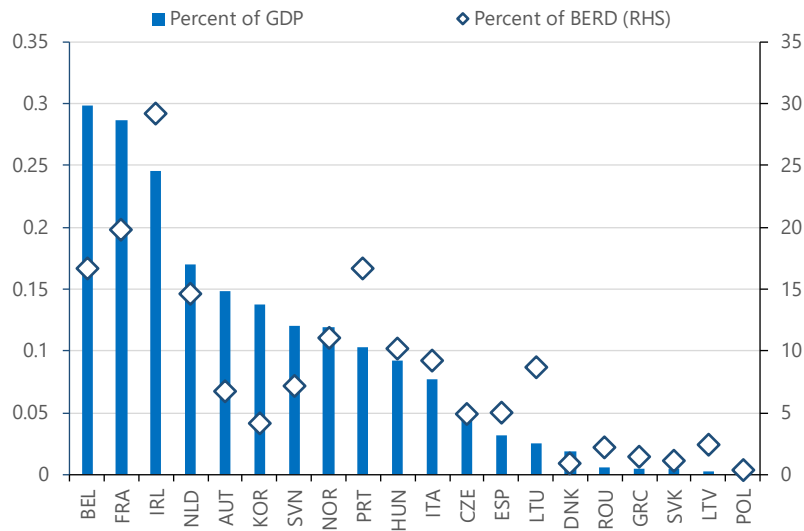
**71. Revenues from removing the 5 percent reduced rate could bring in an additional 0.03 percent of GDP.** At present, 2018 taxpayer data from the business profits tax suggest there are just over 7,800 businesses (out of around 22,800 businesses in the whole regime) with turnover below ALL 14 million, which would qualify for the reduced rate of profits tax. Net taxable profits for these businesses amounted to around 0.3 percent of GDP (from revenues of around 2.8 percent of GDP), suggesting an increase in revenues of about 0.03 percent of GDP from an increase in the profits tax rate of 10 percent (from 5 to the standard 15 percent).

**72. Tax incentives that lower the cost of investment are preferable to profit-based tax incentives (Box 5).** The difference between the two types of instruments is critical. For instance, profit-based incentives—such as tax holidays and exemptions—will be less effective at encouraging investment compared to incentives that reduce the capital cost if profitability is low. Any tax incentive should also be clearly prescribed and consolidated in the tax law and eligibility criteria for granting tax incentives should be clearly defined and readily verifiable to allow for a rules-based approach.

**73. Research and development (R&D) tax incentives can also be considered as a complementary form of public support to businesses (EU 2017).** R&D tax incentives are used widely across Europe and in some countries are a substantial proportion of business enterprise R&D (BERD) investment, including some CEE and SEE countries (Figure 11). The rationale for state intervention in research and innovation is motivated by the economic characteristics of R&D and market failures that lead to its underprovision. These include: (i) the public good qualities of R&D (non-rivalry, non-excludability); (ii) positive externalities and limited appropriability of R&D benefits; (iii) asymmetric information, uncertainty, and the associated

inability to access to finance, and (iv) the indivisibility of large R&D projects. In this way, tax incentives for R&D expenditure are intended to reward firms for the societal benefits from innovation that they themselves are unable to appropriate.

**Figure 11. Indirect Government Support Through R&D Tax Incentives**



Sources: OECD and IMF staff calculations.

Notes: BERD=business enterprise research and development.

**74. While R&D tax incentives can be effective in stimulating business investment in R&D, their design, administration and implementation are crucial for their effectiveness.**

The impact of R&D tax incentives on innovation and productivity is methodologically difficult to capture, as the output effects of (successful) R&D expenditure can take time to materialize.

However, some evidence suggests that the positive impact on stimulating business R&D and is stronger for businesses less than 5 years old and SMEs (CPB 2014). Good practices in the design of R&D tax incentives include carry-forward provisions, cash refunds or relief from labor taxes for the employer, such as payroll taxes or employer social contributions, which are paid by the budget and which can stimulate R&D—also in new companies with negative tax liability.

### Box 5. Choosing the Right Tax Incentives<sup>1</sup>

**Tax incentives are favorite policy tools for stimulating investment and—especially in developing economies, where they have become increasingly widespread—attracting foreign direct investment.** The latter are believed to not only bring capital and (high-wage) jobs to a country but can also spur competition and increase the efficiency of domestic markets more widely, thus contributing to a country's overall economic development. Tax incentive policies also often aim to promote specific economic sectors or types of activities as part of an industrial development strategy or to address regional development needs. Countries differ with respect to the type of incentives used, with high-income countries relying more on investment tax credits and favorable tax treatment of research and development (R&D), low-income countries relatively more often offering tax holidays and reduced tax rates, and middle-income countries most often having preferential tax zones (in which income can be tax exempt and other favorable treatments may apply).

**Tax incentives are often found to be redundant in attracting investment in developing countries.** In other words, the same investments would have been undertaken even if no incentives had been provided. Redundancy implies that the tax incentives are a mere cash transfer to the investor. On the other hand, for projects that would not have been undertaken without the incentive, there is no direct revenue loss—so long as taxation of the incentivized activity is not eliminated, there may in fact be a net revenue gain from those projects. To minimize the revenue cost of tax incentives, the goal would thus be to offer tax incentives only to those marginal investors who would not have invested otherwise.

**Tax incentives that lower the cost of investment are often to be preferred over profit-based tax incentives:**

- **Cost-based tax incentives involve specific allowances linked to investment expenses, such as accelerated depreciation schemes and special tax deductions and credits.** They are targeted at lowering the cost of capital and so make a greater number of investment projects more profitable at the margin—that is, may generate investments that would not otherwise have been made.
- **Profit-based tax incentives generally reduce the tax rate applicable to taxable income.** Examples include tax holidays, preferential tax rates or income exemptions. One effect is thus to forgo government revenue in order to make even more profitable investment projects that would be profitable, and hence undertaken, even without the incentive. By offering temporary tax relief for profitable firms, tax holidays benefit industries that start making profits soon in the holiday period. This introduces a bias towards short-term projects with low upfront investment costs, which may be those least likely to generate spillover effects on the wider economy. Such investment projects are known to “pack and go”, fleeing the host country as soon as the preferential treatment is removed. For industries with significant long-term capital needs, and for which spillover benefits may be greater, tax holidays could actually discourage investment.

**The difference between the two types of instruments is critical.** For instance, profit-based incentives will be less effective in encouraging investment compared to incentives that reduce the capital cost if profitability is low. When profits are earned due to the presence of location-specific factors, such as natural resources, agglomerations, or local markets, profit-based incentives tend to be associated with high redundancy rates and are again ineffective in raising investment. But international considerations are important here. Profitable investments that are highly mobile across national borders—because, for instance, rents are associated with intangible assets, such as patents or trademarks, that are easy to move between jurisdictions—may be sensitive to both cost-based and profit-based tax incentives.

<sup>1</sup> The material in this Box is drawn from the 2015 IMF Board Paper on “Options for Low Income Countries’ Effective and Efficient Use of Tax Incentives for Investment”, available at: <https://www.imf.org/external/np/g20/pdf/101515.pdf>.

## Treatment of Small Taxpayers

**75. The current system of taxation for small businesses is complex and distortionary and needs to be simplified.** Profits taxation inherently comes with a substantial compliance burden for businesses to maintain a certain level of records, and for this reason, only larger businesses should be subject to such obligations in the general business profits tax scheme. For smaller businesses, the simplified profits regime should be converted into a simplified presumptive regime with a turnover threshold and a lower tax rate on turnover, as well as more simplified accounting requirements.

**76. Presumptive taxation is typically used to reduce the costs of compliance and administration for SMEs.** Turnover is commonly used as the “presumptive” or “simplified” tax base for such regimes. The rationale for this approach is that sales (turnover) are relatively easier to measure, record, and verify than profit, while the fixed costs of complying with and administering regular business profits taxation makes that system regressive for SMEs. A fixed tax regime (“patent system”) can also be implemented for the smallest businesses—for example, subsistence self-employment activities—with turnover less than ALL 1 million. For these businesses, a fixed annual payment of ALL 50,000 could be levied.

**77. Both the rate and the threshold for the new simplified turnover-based regime for small businesses should be carefully calibrated.** Wei and Wen (2019) find that the optimal threshold is generally between about US\$100,000 and US\$150,000 (which corresponds to between ALL 11 million and ALL 16 million), depending on the value added per firm of a country. The current SPT threshold is ALL 8 million and the reduced rate of the business profits tax applies for turnover below ALL 14 million. Given businesses familiarity with these two definitions, it would be advisable to choose a threshold at one of these levels. Wei and Wen (2019) also suggest that the optimal turnover tax rate should be close to 3 percent if a single tax rate is being applied to all sectors of the economy.

**78. However, the determination of both rate and threshold requires policymakers to take a number of factors into consideration:**

- **The presumptive tax should attempt to be horizontally “neutral” in the sense of equalizing the after-tax profit margins across tax regimes.** Operationally, this would imply choosing a turnover tax rate that would be equivalent to applying the 15 percent standard business profits tax rate to the average margin for small businesses. Profits margins calculated using small business tax return data—and the implied turnover tax rate—is summarized in Table 5.

**Table 5. Albania: Profit Margins from Taxpayer Returns**

	Average of individual tax returns	Average by NACE Activity	Average by Sector
<b>Businesses under general BPT</b>			
Profit margin	10.51	11.42	12.1
Implied turnover tax rate	1.58	1.71	1.81
<b>Businesses under SPT</b>			
Profit margin	32.9	32.3	35.7
Implied turnover tax rate	4.9	4.8	5.4

Sources: GDT and IMF staff calculations.

Notes: BPT=business profits tax; SPT=simplified profits tax. NACE=statistical classification of economic activities in the European Community.

- **There should be some vertical non-neutrality, which produces a gap between the regular corporate income tax rate and the presumptive turnover tax rate.** What this means is that the effective tax rate on income implied by the turnover tax, should be marginally more onerous at the threshold than the burden under the regular tax—after adjusting for the increased compliance costs of transitioning to the new system—in order to encourage firms to grow and graduate to the regular profits tax system.
- **Such migration from the simplified and general regime can be encouraged by allowing for businesses to voluntarily register for the profit tax.** To the extent that the threshold would be aligned with that for the VAT (see Section III), such voluntary registration should be limited only to small businesses with turnovers close to the threshold, for example between ALL 5 million and ALL 8 million.
- **More generally, when determining the tax rate on turnover under the simplified scheme, it is important to highlight that the rate must be much lower than that for profits.** Turnover as a measure of business activity is blind to net margins—and, therefore, the viability-of a business. When businesses are taxed on their sales, they would have to pay tax even when making small profits or losses and setting too high a tax rate on turnover can make the difference between survival and failure. As businesses can make losses or low profits due to large investments, too high a tax rate on turnover could act as a disincentive to making those investments. In addition, too high a rate could be a major burden on new companies in their early years and could, therefore, discourage business growth more broadly.
- **Furthermore, when setting the turnover tax rate, care must be taken not to push firms in the presumptive system into the patent system.** Worse still would be to push small businesses and individuals into the untaxed and low-productivity informal sector.

**79. At a rate of 3 percent, the potential yield from a turnover tax from activity currently declared under the SPT—below a threshold of ALL 8 million—could generate up**

**to an additional 0.22 percent of GDP.** With a higher threshold, the authorities could also bring those businesses with turnover greater than ALL 8 million and less than ALL 14 million that are currently taxed at a 5 percent rate on their profits into the new small business scheme. However, it is unclear whether compliance burdens for these businesses are high and moving them into the new scheme would also not raise significant revenue. Using 2018 GDT data on businesses in the general business profits tax regime, 35 percent of businesses have turnover below ALL 14 million. Tax revenues from these businesses (at the reduced rate) were 0.05 percent of GDP from reported turnover of 2.8 percent of GDP. If these businesses were moved into the new presumptive turnover-based regime, tax revenues would only increase by an additional 0.03 percent of GDP. Therefore, assuming low compliance burdens, it would be preferable to retain these businesses in the general regime and instead subject them to the standard profits tax rate of 15 percent.

### **Treatment of Self-Employed (Professional) Individuals**

#### **80. Self-employed professional individuals should be subject to personal income tax.**

To address the ability of individuals to manipulate their tax liability by altering their business form, self-employed individuals operating within the “free professions” should be carved out of the proposed simplified (presumptive) small business regime and brought into the personal income tax regime. This will help restore neutrality between a class of taxpayer that is virtually indistinguishable from employees in terms of their earnings—which are essentially returns to their specialized, high-skilled, and certified/licensed human capital that are otherwise equivalent to wages (after factoring in a minimal expense component). The difference in social security contributions between the employed and self-employed—marginally less onerous for the latter—will help compensate those highly-skilled self-employed entrepreneurs that are genuinely engaged in higher risk ventures. These self-employed individuals will still be required to register and charge VAT for their services if they are over the VAT threshold of ALL 8 million. And for the purposes of taxable income under the PIT, they can also be allowed to deduct a maximum deemed expense, for example, 10–20 percent of income.

**81. Bringing the “free professions” into the PIT will help this particular tax reach its fuller revenue potential.** As mentioned earlier, current taxpayer behavior—including informality, under-reporting of incomes, cash wages, and the inclusion of the self-employed in the SPT—have undermined the PIT, limiting the contributions it makes to domestic revenues. The “free professions” have already been identified with respect to their treatment under the VAT, for which currently all are expected to register regardless of turnover they include.<sup>7</sup> It will be important to exploit this list of individuals captured under the VAT—as well as any existing information-sharing arrangements with professional societies and certification boards that

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<sup>7</sup> These include: lawyers, notaries, specialized doctors, dentists, specialized dentists, chemists, nurses, vets, architects, engineers, approved accountants and estate appraisers, and individuals that conduct economic activity in the fields of hospitality.

maintain registers of their licensed members—to ensure that all professionals migrate over to the PIT.

**82. The revenue from the “free professions” is potentially higher if they are shifted over to the PIT.** At present, there are over 8,000 physical persons operating in professional services (accountants, architects, business consultants, computer programmers, dentists, engineers, medical professionals, and lawyers). These businesses generate up to 1 percent of GDP in turnover and pay 0.1 percent of GDP under the VAT. Cross-checking with information in the SPT, approximately 7,000 physical persons from the same categories generate a similar amount of turnover and negligible taxes. Under this recommendation, these businesses would instead be recorded and taxed under the PIT—preliminary estimates suggest that this group could generate around 0.4 percent of GDP under the PIT and over 2 percent of GDP of social contributions.

**83. Eventually, all categories of self-employed individuals should be taxed under the PIT.** Once control and audit functions are in place for the “free profession” the authorities can consider bringing other self-employed individuals (i.e., other businesses with 0 employees) from the SPT into the PIT.

**84. As the number of taxpayers in the PIT is set to grow with the addition of self-employed individuals, it is advisable to remove the ALL 2 million reporting threshold.** This threshold was introduced to ensure that individuals that earn additional income not already subject to withholding is recorded and taxed under the PIT. However, with the addition of self-employed professional individuals in the PIT, it will be important for them to declare all of their income—from self-employment and other sources—in their tax returns to ensure all (untaxed) income is subject to PIT at the appropriate rate. To ensure consistent treatment across all taxpayers in the PIT, all employees should also file additional income not already reported by their employers or other withholding agents. More generally, it is important to obtain as complete a picture as possible of all sources of income from individuals in the PIT to help with sound policy analysis.

### **Taxation of Capital Gains**

**85. With a high CGT on gains from property, there is a risk that sales prices are under-reported to avoid a large liability.** To mitigate such avoidance, gains made after a certain period could be subject to a lower rate of CGT. If inflation is high or persistent, the purchase price could also be partially-adjusted for inflation to limit the size of the gain and the associated excessive tax consequence. Any changes to the CGT base should be aligned with changes in the cadaster which are underway in the property tax (see Section V).

## International Tax Issues<sup>8</sup>

**86. In May 2019, Albania became the 88<sup>th</sup> jurisdiction to sign the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.** This was in line with previous TA recommendations from the November 2018 FAD Tax Policy TA report. However, the effort needed to retain and exercise source taxation rights (without jeopardizing Albania's tax competitiveness) remains an important issue and the key recommendations of the previous TA report still stand:

- **Albania must design a proactive tax treaty policy, well beyond the MLI, firmly under the control of the MoF, with a view to obtain a net benefit from tax treaties.** A large proportion of treaties in effect at present are with countries that have very little commercial connection to Albania and can serve as vehicles for treaty shopping. As such, Albania's large tax treaty network displays substantial inconsistency and is costly to administer. In many cases Albania has given away important source country taxing rights and often to countries that classically act as conduit locations.
- **Albania should also develop a clear and balanced policy towards the conclusion of tax treaties.** Albania should refrain from concluding tax treaties with financial centers and countries that do not have an income tax. It should focus its resources on the renegotiation of tax treaties where its rights as a source country are substantially eroded.
- **Albania should withdraw its current model tax treaty which gives away too much in terms of Albania's taxing rights as a source country.** In the future it should negotiate tax treaties based on the UN Model, as revised in 2017. Particularly, in negotiating tax treaties it should pay attention to not reducing withholding taxes for interest and royalties below 10 percent and including the right to impose withholding tax on technical service fees (and should try to renegotiate those with zero withholding rates). It should use the broad UN definition of PE as well as the limited force of attraction rule for allocating payments to an Albanian PE. It should also retain the right to tax offshore indirect transfers of immovable property. Tax treaties themselves are an overlay to the international features of domestic income tax law.
- **Albania's source rules need redrafting, particularly to clarify factors that connect source to Albania.** These rules also need to be expanded to cover offshore indirect transfers of immovable property and services fees paid by residents and Albanian permanent establishments (PEs). Also, there is an asymmetric treatment favoring branch profits—when they are remitted to headquarters, they are not subject to a withholding tax, while the repatriation of dividends by subsidiaries is. Not surprisingly, some of the large investments in Albania are through PEs. Moreover, the domestic definition of PE is too narrow and should

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<sup>8</sup> This section draws from the November 2018 FAD Tax Policy TA report: Schatan, R., N. Nersesyan, and P. Harris. 2018. "Tax Treaty and BEPS Issues".

be expanded to be at the least as broad as the definition in the UN Model. Albania might also consider tightening its interest limitation rule and introducing a GAAR along the lines of the principal purpose test used in tax treaties. It should investigate with the Ministry of Justice the potential for introducing a simple limitation of benefits clause in domestic law.

## V. PROPERTY TAX

### A. Current System

**87. The property tax law was amended at the end of 2017 to introduce a valuation system that is based on the market value of the property.** The development of the National Fiscal Cadaster has started that will serve as a basis of property valuation over time, but there have been delays to the original timeline of the development. Until the cadaster provides sufficient information for property valuation, the tax base is determined by so-called minimum reference prices that are defined by an expert council for each municipality. Municipalities have the right to adjust the reference price for urban and rural areas, up to 35 percent of the referral price. The property tax rate is defined as a band of 0.035–0.065 percent of the base for residential properties and 0.2–0.36 percent of the base for commercial properties and municipalities can set the rate within these bands.

**88. Several groups are exempt from the property tax,** such as pensioners living alone, state and local government buildings, public properties transferred to public enterprises, buildings used for social services and social housing, and 4-/5-star hotels. The authorities expect around ALL 3.2 billion revenues from the recurrent property tax this year, and some ALL 1 billion more next year.

### B. Reform Proposals

**89. The current system of the recurrent property tax is based on sound principles and the finalization of the fiscal cadaster will improve the valuation system.** The authorities should ensure that the cadaster will be developed on time and the property tax system will transition to use that as the basis of the valuation.

**90. The property tax is exempted for several taxpayer groups that should be eliminated.** The property tax can be an important own-source of revenue for local governments, and therefore exemptions should be kept to the minimum not to undermine the revenue take of this source. Relief from the property tax for vulnerable groups should be provided in other forms instead of exemptions.

**91. The currently applied rates of the property tax are relatively low, which is a reasonable choice during the introduction period.** The tax rate can be raised substantially over time to increase revenues from the property tax. Compared to the 0.3 percent of GDP revenues in Albania, the average revenue from property tax is around 0.8 percent of GDP in comparable countries, a level that Albania could also aspire to in the medium term.

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## Annex I. Composition of Taxes in Regional Comparison

Tax Revenue Shares (percent)	Income taxes				Taxes on goods and services	Taxes on trade	Other taxes	Total tax revenues (percent of GDP)
	PIT	CIT	Other IT	Total IT				
Albania	11.2	10.7	0.0	21.8	69.6	1.9	6.6	20.1
<b>Central and Eastern Europe: EU members</b>								
Hungary	21.9	5.4	0.0	27.3	71.8	0.7	0.2	25.3
Poland	23.7	9.7	2.4	35.8	52.0	1.2	10.9	21.9
Slovenia	25.4	8.8	0.0	34.1	62.0	0.9	2.9	21.1
Czech Republic	21.4	16.3	1.1	38.8	61.2	0.0	0.0	20.2
Slovak Republic	19.6	17.6	2.9	40.2	59.8	0.1	0.0	18.2
<b>Southeastern Europe: non-EU countries</b>								
Croatia	12.4	8.8	0.4	21.5	75.8	0.0	2.7	26.5
Bulgaria	16.1	10.8	0.0	26.9	67.0	1.0	5.1	21.1
Romania	16.6	12.5	0.0	29.1	61.8	0.7	8.3	15.1
<b>Southeastern Europe: EU members</b>								
Monetenegro	13.4	5.6	0.0	18.9	68.7	2.2	10.1	26.4
Serbia	14.9	9.4	0.0	24.3	65.7	3.6	6.4	23.8
Kosovo	9.4	5.3	0.0	14.8	75.7	7.6	1.9	23.4
Bosnia and Herzegovina	..	..	..	17.4	78.9	3.7	0.0	22.9
North Macedonia	14.6	10.9	0.0	25.5	67.7	5.0	1.8	15.9

## Annex II. FAD Tax Policy TA Advice Since 2015

TA period	TA advice/recommendations	Quantification, if any	Notes
<b>General Tax Issues</b>			
December 2017	Adopt a strategic approach to tax avoidance by improving clarity of the law through inclusion of exhaustive definitions, practice and interpretation notes, explanatory memorandums, or guidance notes simultaneously or shortly after tabling of primary legislation.	+	
<b>Value-Added Tax</b>			
December 2017	<b>Maintain a single registration turnover</b> threshold at the current ALL 5 million (about US\$44,000) level and abrogate all special rules that require mandatory registration in certain sectors irrespective of turnover. Periodically review the threshold to align it to the distribution of businesses that generate the bulk of taxable supplies and index it to inflation.	+/-	From <b>April 1, 2018, the minimum registration limit for VAT is a turnover of ALL 2 million</b> in one calendar year. <b>Threshold is zero</b> for taxable persons, who provide services in economic activities: lawyer, notary, specialist doctor, dentist, specialized dentist, pharmacist, nurse, veterinarian, architect, engineer, physician-laboratory, designer, economist, agronomist, registered accounting expert, certified accountant and asset assessor. For agricultural producers threshold is ALL 5 million.
December 2017	Review the revenue and economic impacts of <b>the reduced rate</b> on accommodation after one year and <b>plan to repeal</b> and replace with direct support for industry only if needed.	+	<u>Reduced rate 6%:</u> <ul style="list-style-type: none"> <li>• From June 2017, for the supply of accommodation services by categories defined in the legislation of the tourism sector.</li> <li>• From January 2018, for the supply of any services provided within the "Five-star Hotel/Resort, special status" accommodation, as defined in the legislation in the field of tourism and who are holders of an internationally registered and branded trademark "brand name".</li> <li>• From January 2019, for the supply of accommodation and restaurant services, except beverages, for the structures that develop the hosting activity and are certified as "agro-tourism"</li> </ul>
None	New policy changes – no TA recommendation yet		<u>Reduced rate 6%</u> <ul style="list-style-type: none"> <li>• From January 2019, for the supply of advertising service by audiovisual media</li> <li>• From January 2019, for the supply of licensed public transport vehicles to passengers by bus with nine plus one seat or more, only with electric motor. (From Jan 1, 2022 the rate will be 10%.)</li> <li>• From January 2019, for the supply of different types of books.</li> </ul>
December 2017	Begin the <b>phase out of the farmers' compensation scheme</b> by reducing the comp. rate to 10 percent in 2018, 5 percent in 2019, and zero (abrogation) in 2020.	+0.15 percent of GDP	For agricultural producers to whom the special scheme of the compensation scheme applies and who carry out their economic activity as individual farmers, the minimum registration limit for value

August 2015	Reduce to agricultural flat tax rate from 20 percent to 6 percent.	+0.05 percent of GDP	added tax is the turnover of ALL 5,000,000 (five million) in one calendar year. From January 2019, the compensation vat rate for the agricultural producers (farmers) is <b>reduced from 20% to 6%.</b>
February 2017	Consider applying a preferential VAT rate to sales of <b>pharmaceutical products</b> (as was policy pre-2014), rather than exempting these sales.	+	
December 2017	Tax all non-prescription and over-the-counter <b>drugs and medicines, as well as supplements and vitamins</b>	+0.16 percent of GDP	
December 2017	Tax all sales and leases of <b>commercial property</b> to allow input tax credits to flow through to avoid cascading or ensure input taxation of exempt businesses.	++	
December 2017	Tax newly created immovable property on its full value, including the labor and material used in constructing the property.	+0.84 percent of GDP	
August 2015	Include sale of new residential property in the VAT system	+0.7 percent of GDP	
December 2017	Exempt residential property leases or rentals. Tax initial sales of new residential property (which is sold by property developers) but exempt the resale of residential property.	+	
December 2017	Tax <b>gaming, gambling and lotteries</b> under VAT	+	
December 2017	Tax <b>fee-based financial services</b> and <b>general insurance</b> under VAT.	+0.06 percent of GDP	
December 2017	Tax <b>health and education services</b> provided by the private sector.	++	
December 2017	Disallow voluntary VAT registration below certain threshold, for example, ALL 360,000	+	
None	New policy changes – no TA recommendation yet		<b>Tax policy measures in the 2019 budget</b> (in addition to the ones noted above): Imports of agricultural machinery, raw materials for pharmaceuticals and the processing of foreign goods for re-exports will be exempted from VAT.
<b>Business Income: Corporate Income Tax, Simplified taxation; taxation of SMEs, presumptive tax</b>			
None			<b>Tax Measures in the 2019 Budget:</b> (law 94/2018) <b>profit tax rate:</b> <ul style="list-style-type: none"> <li>• 5 percent for taxpayers with revenues up to ALL 14 million</li> <li>• 15 percent for taxpayers with revenues over ALL 14 million</li> </ul> <b>Preferential rates of 5 percent</b> established for: <ul style="list-style-type: none"> <li>• Legal entities operating on the field of the production/development of programs</li> <li>• Legal entities that carry out economic activities under the law no. 38/2012, "On agricultural cooperatives"</li> <li>• Entities that carry out host activities certified as "agrotourism", according to the legislation in force in the field of tourism. This rate applies for a 10-year period to legal entities that qualify for "certified agrotourism entity" status until December 31, 2021. The application of the reduced rate begins in the following tax year,</li> </ul>

			after obtaining the "certified agrotourism entity" status.
November 2018	Clarify source rules and ensure that they always have a factor that connects the income to Albania		
November 2018	Adopt a payer-based source rule for service fees		
November 2018	Expand domestic withholding tax to cover all service fees		
November 2018	Retain cap on interest deduction as a percentage of EBITDA		BEPS Action 4
November 2018	Tighten the EBITDA rule, applying it to all interest and introduce a special rule for financial institutions.		
November 2018	Ensure that interest substitutes are subject to interest withholding tax		
November 2018	Tax offshore indirect transfers		
November 2018	Expand the definition of PE in the ITR to be broader than that used in the UN Model (2017)		
November 2018	Adopt measures against artificial avoidance of PE		BEPS Action 7
November 2018	Limit Article 26 of the ITR so that it only exempts dividends paid between two resident companies		
December 2017	Simplify tax return forms, reduce the frequency of filing, rationalize different taxes to a single filing date to make employment of audit assistance more cost-effective	+	
December 2017	Introduce a <b>comprehensive presumptive regime</b> – a simple lump sum tax for microbusiness taxpayers – and a single turnover based tax of <b>2.5 to 3 percent</b> for SMEs	+0.07 – 0.2 percent of GDP	
December 2017	<b>Limit the presumptive regime</b> and administrative simplification in scope for businesses with a <b>turnover below the VAT registration threshold</b>	+	
December 2017	The <b>presumptive tax</b> approach should only replace CIT and it should <b>not substitute for VAT</b> as most firms would pay input VAT without the option to charge output VAT	+	
December 2017	<b>Professional service providers</b> should not be taxed under the presumptive regime	+	
December 2017	Keep the system simple by refraining from sectoral differentiation	+	
December 2017	Assure proper segmentation of taxpayers—align <b>presumptive taxation thresholds with the current VAT registration threshold</b> of All 5 million	+	
December 2017	Provide for simplified accounting and quarterly filing for medium-sized taxpayers as they migrate from the SME turnover regime into the standard CIT system	+/-	
February 2017	Treat as a tax expenditure tax relief arising from preferential taxation of unincorporated business income under the simplified profit tax		
February 2017	Remove the 50 percent profit exemption from the list of tax incentives offered in special <b>economic zones</b> (TEDAs)		
August 2015	<b>Economic zones.</b> Tax preferences for economic zones (EZ) firms should be limited to indirect taxes. Firms should pay profits tax in full.		

February 2017	Conduct a cost-benefit analysis for projects in TEDAs, taking into account all fiscal tax incentives retained in the TEDA legislation, and modify zone legislation as necessary		
	<b>Treaty Policy:</b> <ul style="list-style-type: none"> <li>• Focus tax treaty policy on renegotiating existing tax treaties to secure greater and consistent source country taxing rights</li> <li>• Refrain from negotiating tax treaties with financial centers and countries that have no income tax</li> <li>• Base future tax treaty negotiations on the UN Model</li> </ul>		
<b>Personal/Individual Income Tax, Social Security, Payroll, etc.</b>			
December 2017	Maintain the current structure of the PIT, including its progressivity and the established rates.	Neutral; -0.1 if top PIT rate is reduced	Tax Measures in the 2019 Budget: the highest income tax bracket (taxed at 23 percent) will increase.
December 2017	Consider lowering the upper bound of the second bracket to compensate for the revenue loss if the top PIT rate is reduced	+/-	
December 2017	Preserve progressivity and fairness of the tax system by maintaining the tax-exempt threshold above the level of the minimum tax wage	+/-	
December 2017	Ensure a proper segmentation of taxpayers to limit opportunities for arbitrage	++	
December 2017	Ensure the horizontal fairness of effective tax burdens on identical income earned by taxpayers in different sectors, and organized either as natural or legal persons	++	
December 2017	Treat mandatory and voluntary pension schemes symmetrically, allowing deductibility of all pension contributions and taxation of all pension benefits.	+/-	
None	New policy changes – no TA recommendation yet		<b>Tax Measures in the 2019 Budget:</b> A reduction from 15 to 8 percent in the withholding rate on dividends, including from previous years if declared in 2019
February 2017	Treat as a tax expenditure the deduction given for contributions to private pension funds		
February 2017	Set an annual limit on deductions for contributions to private pension funds, in order to better target aggregate tax relief to encourage retirement savings		
August 2015	Reduce the zero-tax threshold from ALL 30,000 to ALL 25,000.	+0.1 percent of GDP	
August 2015	<b>Social security contributions.</b> Increase the cap on employee's share of the social security contributions from ALL 97,000 to ALL 200,000.	+0.1 percent of GDP	
<b>Excise Tax</b>			
August 2015	Introduce a solid waste tax for aluminum and cardboard products similar to plastic products based on weight but at lower rates	+	
August 2015	Introduce an excise tax on liquefied petroleum gas (LPG) at a rate of ALL 10/kg	0.2 percent of GDP	
December 2017	Impose the standard VAT rate on e-cigarettes. If currently allowed, withdraw exemption on the sale of nicotine replacement therapy (NRT) over the counter outside clinical requirements	+	

December 2017	If required by revenue needs, tax e-cigarettes at a capped rate of 30-40 percent relative to the minimum excise tax on 1,000 pieces of cigarettes as set for the category of the weighted average retail price of cigarettes	+	
August 2015	Increase the current tax rates on plastic bags and other packaging materials from ALL 100/kg to ALL 200/kg.	+ 0.2 percent of GDP	
December 2017	Underpin the current environmental charging regime (for plastic and glass) with supporting regulations that would prohibit the importation and use of single-use bags	+	
December 2017	Increase the specific charges payable on plastic shopping bags, plastic bottles (between EUR 5-10/Kg), aluminum cans, and incandescent light bulbs to discourage their use and encourage recycling through refund mechanisms—paying out nominal fees for return of cans and bottles	+ 0.23 – 0.47 percent of GDP	<b>Tax Measures in the 2019 Budget:</b> Environmental tax. The tax on plastic packaging will be cut drastically, but extended to a wider range of plastic products, and differentiated between imported and domestically produced plastics.
None			<b>Tax Measures in the 2019 Budget:</b> Duties on cigars and cigarillos increased (NN: by how much?)
<b>Property Tax</b>			
October 2017	Increase <b>tax rate for residential properties</b> (introduce appropriate hardship relief)		Explanation: The tax revenue from residential properties is currently low and there is room to increase property tax rate—especially if appropriate hardship relief is also introduced.
October 2017	Some <b>differentiation between residential and non-residential/commercial tax rates</b> may be justifiable but should remain within acceptable limits		
October 2017	Consider a <b>transitional approach</b> whereby the new building tax is introduced with initially low rates that are only gradually increased to achieve the 1.0 percent of GDP revenue importance.	Gradual; to +1 percent of GDP	
October 2017	Taxpayers with multiple properties should pay the applicable building tax to each LGU where properties are located, honoring the benefit principle.		
October 2017	As the burden of the building tax increases, tax relief for low-income households and those in hardship should be designed and relief granted on application, reviewed annually, and be means-tested.		
October 2017	In the case of the severe hardship in respect of the elderly, tax deferral should be considered and the tax recouped (with interest) when the property is sold or bequeathed.		
October 2017	<b>Transfer tax on immovable property:</b> <ul style="list-style-type: none"> <li>Maintain a low-rate, value-based property transfer tax (ad valorem on transaction value) as an acceptable alternative, at least until an advanced and revenue productive recurrent immovable property rates system has been established across Albania</li> </ul>		

Other taxes, including Natural Resource taxation			
August 2015	<b>NR:</b> In addition to a fixed royalty rate for metals and the current profit tax, consider introducing a comprehensive tax package which also includes a progressive rent capture instrument for metallic minerals similar to fiscal regime for oil	+	
August 2015	<b>NR:</b> Replace the current ad valorem royalty on nonmetallic minerals with specific royalty rates based on volume or weight. Target an average royalty rate to generate sufficient revenue	+0.07 percent of GDP	
August 2015	<b>Motor vehicle taxes:</b> In addition to the existing used car tax, introduce a registration fee for motor vehicles at EUR 500 for luxury cars and EUR 200 for other cars Introduce an annual circulation tax at EUR 100 for luxury cars and EUR 50 for other cars	+0.4 percent of GDP	
	<b>Insurance premium tax:</b> Either repeal the insurance premium tax and tax insurance companies under VAT or increase the premium tax to six percent	+0.05 percent of GDP	