



SIGMA

Support for Improvement in Governance and Management in Central and Eastern European Countries

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SIGMA BALKANS REPORT¹

2002

REPUBLIC OF ALBANIA TAX ADMINISTRATION

1. Present Situation

Eleven years after revolution and the fall of communism, Albania is still in an initial stage of transition. The collapse of the “pyramid” investment schemes in 1997 caused anarchy and widespread mistrust against fiscal governance. Although major fiscal reforms have been initiated and implemented in recent years (e.g. VAT was introduced in 1996), still lacking is a comprehensive approach to reforming the tax system so that it is suitable for a market economy.

Tax Policy

Revenue Mobilisation: The Albanian Government is committed to closing the budget deficit by increasing tax revenues and keeping spending in check. In 2001, central government tax collection (the ratio of tax revenues to GDP) reached 19.4 per cent (19.1 per cent in 2000).² This figure is very low compared to other countries in the region.³ Table 1 allows for an analysis of central government revenue according to relevant sources.

Table 1: Revenue of the Central Budget 2001 (percentage of GDP)

Total Tax Revenue	19.4
Direct Taxes	7.4
Taxes on Income	7.1
Personal Income	1.0
Corporate Income	1.7
Small Business Tax	0.4
(Social Security Contributions)	3.8
Other direct taxes	0.3
Indirect Taxes	8.6
VAT (on domestic and on imported goods)	7.0
Excise Taxes (tobacco, coffee, petrol, etc.)	1.6
Trade Taxes	2.2
Customs duties	2.2

Source: IMF (2002)

¹ This document has been produced with the financial assistance of the European Community. The views expressed herein are those of SIGMA and can therefore in no way be taken to reflect the official opinion of the European Community or the OECD

² excluding local government finance (e.g. property tax)

³ Among other countries in transition in MOE, the lowest rates besides Albania are those of Lithuania (27.4 per cent of GDP) and Romania (28.3), while other Western Balkan countries, such as neighbouring Macedonia (31.7), the Federal Republic of Yugoslavia (39.5) and Croatia (37.3), show significantly higher collection rates.

One of the explanations for this low government intake is related to the structure of the economy, which depends to a large extent on a strong informal sector producing mainly non-tradable goods and services. In addition, an analysis of the revenue administration reveals that there is potential for improving overall efficiency and effectiveness.

Table 1 shows that in 2001 VAT was the most important source of revenue. Since the increase of VAT from 12.5% to 18-22%, and the combined offering of new exemption rules and new invoices, revenue from this source has grown significantly.

On the other hand, direct taxation in general contributes little to government revenue; the bulk of revenue from direct tax sources stems from social security contributions. Nevertheless, overall revenue from social security is very low compared to other countries in the region. As revenue from social insurance is relatively important, there is a need to improve the co-operation between the General Taxation Department (GDT) and the Institute for Social Insurance (ISI) (see below).

Legal Framework: In principal, major instruments of modern taxation exist. Nevertheless, although income tax on personal income and business profits is levied according to one comprehensive law on income tax, legislation still shows elements of a schedular system. The tax base for Profit Tax (PT) is relatively narrow, as only registered VAT taxpayers are taxable under PT. Businesses which are not subject to VAT are taxable under the Small Business Tax (SBT).

Key features of the VAT system comprise a relatively high threshold of 8 m Lek and a very simple VAT legislation (only a very limited number of goods is tax exempt or zero-rated). On the one hand, the number of registered taxpayers liable to VAT is relatively small,⁴ but on the other hand, VAT seems easy to administer.

Small businesses, whose turnover exceeds 2 m Lek but not 8 m Lek, are subject to the Small Business Tax (SBT). This tax consists of a fixed amount of tax, defined according to the type of business and business location, and a turnover tax.

Fiscal Decentralisation: Local governments are financed through a mixed system of transfers and own revenue (basically property tax and local fees).

Tax Administration

Institutional Framework: Legally, the responsibility for formulating revenue policy rests with the Ministry of Finance (MoF). In practice, the MoF does not seem to provide for enough capacity, and neither does the General Taxation Department (GDT), to which the responsibility for formulating tax policy has been passed in reality.

Revenue administration is under the responsibility of the GDT and the General Customs Department (GDC), both under the Ministry of Finance. The GDT is in charge of collecting inland taxes. Import duties as well as excises and VAT on imports are collected by GDC. As for tax and customs revenue, GDC contributes 56 per cent of the total, while GDT contributes 44 per cent to state coffers. Progress in implementing reforms relating to the internal organisation of GDT may be hindered by the present government's focus on short-term revenue targets and by the often changing management.

In 2002 the division of tasks between GDT and GDC has been under discussion, with special reference to excise collection and responsibility for inland warehouses for customs and excises. This

⁴ The VAT threshold – turnover exceeding 8 m Lek – is equivalent to 60,000 EUR. At the end of October 2002, 7,909 taxpayers had registered for VAT, while under SBT 36,537 had registered.

matter is of particular concern for revenue collection given existing shortcomings in levying taxes and customs on tobacco and coffee.

The Institute of Social Insurance (ISI) is in charge of collecting social security contributions. However, ISI's administrative capacity seems to be very limited, leaving social security as a voluntary contribution. Therefore, following the advice of international donors, plans are under development to either transfer responsibility for social security contributions from ISI to GDT or merge the two institutions.

The GDT (total staff: 1,387 persons) consists of headquarters, Tirana office, Large Taxpayer Office (LTO), and 35 local offices. Following international advice, a new functional based organisational structure for GDT has been approved in 2002. However, its implementation is still pending, and with a staffing of 94 officials, GDT headquarters is understaffed and therefore capacity for managing the field operations is severely limited.

Assessment and Information Technology: Regarding income taxation, GDT applies a desk assessment system, while the VAT system is based on self assessment. The procedures for declaring and assessing income taxes is complex, leaving the taxpayer with a heavy compliance burden. From the administration's point of view, desk assessment is costly and time-consuming because only four tax offices are computerised as a result of previous efforts for computerisation, whereas most taxes are administered manually.

Procedures: Taxpayers are registered with the tax administration under different systems of identification numbers, depending on whether a taxpayer is liable to VAT, income tax, or SBT. As this system is extremely complicated and prone to errors, there is a strong need to create a unified registration system, relying on IT-based procedures.

Collection and Enforcement: Payment of tax dues is done via bank transfer. While payment procedures are very modern, auditing and enforcement are of major concern for reform. First of all, large amounts of tax arrears of state-owned enterprises remain an unresolved problem for the revenue administration. Secondly, GDT lacks a strategy for auditing taxpayers. According to the law, tax audits must be comprehensive. From an HRD point of view, this provision is unrealistic, but it leaves little room for developing audit strategies which are based on risk analysis. Thirdly, competencies for auditing are not clearly designed, and there is considerable room for improving co-ordination among different audit services under the Tax Audit and Inspection Unit of GDT. Fourthly, procedural legislation grants the GDT far-reaching competencies, including the right to close down bank accounts.⁵ GDT applies the policy of using these competencies to freeze accounts, a first step in debt recovery. Fifthly, the role and organisation of the Financial Police as an instrument of the MoF is not clear.

2. Programmes Underway and Envisaged

At the moment, only few donors are active in the Fiscal Administration. While IMF provides technical assistance derived from frequent short-term missions of its Fiscal Affairs Department, DfID and EU deliver long-term advice.

Support to the Tax Administration Reform (STAR): Since 2001, under a UK Department for International Development (DfID) contract, PriceWaterhouseCoopers (PWC) provides technical assistance implementing the STAR project. During phase 1, STAR assisted GDT in developing a comprehensive reform strategy and in preparing and partly implementing organisational reforms. The

⁵ The ominous Article 45 of the Law on Tax Procedures allows for GDT to order defaulters' banks to freeze bank accounts.

diagnostics tool formed the basis for training, legislation and computerisation intentions, which may be implemented during phase 2 (2002-2005).

Customs Assistance Mission to Albania (CAM-A): In 1997, CAM-A was established with the initial goal of re-establishing the GDC and restoring its capacity to collect revenue. CAM-A is based on a formal memorandum between the EC and the Government of Albania and financed mainly by the European Union, while USAID and the World Bank contribute financially to this programme. The work programme includes assistance to reorganisation, legal reform, and computerisation of the GDC.

Computerisation of GDT - Envisaged EU programme: Currently, a new EU programme focusing on computerising the GDT (volume: 2 m EUR) is under consideration. This programme perfectly meets GDT's needs for improving efficiency and effectiveness.

3. Recommendations and Priorities

The legal framework of modern taxation basically exists, although some review and amendments are still needed. Major shortcomings exist in implementation. This implementation gap and the lack of capacity in the revenue and enforcement services will require the serious attention of the Albanian authorities.

We recommend giving priority to the following actions:

- Further development of a tax policy framework in accordance with international standards and a tax administration capable of applying modern techniques. In this context, attention has to be given to the development of supporting instruments, e.g. financial reporting, tax forecasting, financial statistics.
- Immediate implementation of the principal agreement to integrate social security collection with the GDT (November 2002) to improve overall revenue performance.
- In view of the envisaged negotiations of the Stabilisation and Association Agreement, the tax legislation should be reviewed to ensure its compatibility with EU requirements.
- To maximise the value-added of the planned project, donors should pay considerable attention to linking computerisation efforts with ongoing assistance regarding reorganisation. Computerisation exerts intense effects on organisational design as well as on procedures of a tax administration and vice versa. While the institutional set-up of the computerisation project is not clear at this stage, general understanding hints to a situation in which CAM-A may be involved in implementing EU's computerisation programme, while PWC's mandate for providing advice on reorganisation of the GDT is prolonged.