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Potential Additional Revenues for Kosovo

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Executive summary

Kosovo has inherited a weak economy, and dilapidated infrastructure. The main objective of the Kosovo Government is to create preconditions for economic growth. The objective of this research is to find the potential for additional revenues, by finding possibilities to intervene on existing taxes and introducing new taxes, and in the same time to take into account the harmonization of taxes with EU and region countries. Three sources of potential extra revenues were considered such as VAT, excise tax, and introducing new tax as transfer on real estate and as transfer on vehicles.

Considering various scenarios, which are explained within the project, the summary of all those scenarios is given below in these two matrixes:

Scenarios Summarizing Analysis for VAT (Million Euros)

Total revenues	High VAT	Medium VAT	Low VAT
High other	333.66	274.65	245.43
Medium other	290.75	231.74	202.52
Low other	250.59	191.58	162.36

Scenarios Summarizing Analysis for Excise tax (Million Euros)

Total revenues	High	Medium	Low
High others	333.66	231.74	266.34
Medium others	264.15	231.74	196.83
Low others	229.68	197.27	162.36

Government has the options of raising 333.66 million Euros by adopting High scenarios from all three sources VAT, excise, and tax on transfer of real estate and vehicles. Government has the option of raising 162.36 million Euros applying when all low three scenarios.

If Government wants to raise about 250 Million Euros revenues there are two options, to be considered in the VAT matrix and two options in excise tax matrix. Considering the low scenario VAT scenario together with other scenarios, it raises 245.43 million Euros with high VAT

scenarios combine with other low scenarios it raises 250.59 million Euros. Also, with low excise tax scenarios it raises 266.34 million Euros. Finally, the high excise tax scenarios with the medium other scenarios it raises 264.15 million Euros.

If Government wishes to raise around 200 million Euros there are four options to consider from VAT scenarios matrix having the low VAT scenario together with medium other scenarios there are 202.52 million Euros. Than with the medium VAT scenarios together with medium and other low scenarios there is 191.58 million Euros. Using excise tax scenario matrix with the low excise tax together with all medium scenarios there is 196.82 million Euros. Finally with in the medium excise tax scenarios matrix together with other low scenarios there is 197.27 million Euros.

This capstone project report has collected all the financial data for VAT revenues, Excise revenues, and new introduced tax as transfer on real estate and as transfer on vehicles. Analysis of these collected data was executed via excel spreadsheets, and matrix tables. The data for VAT are taken from Kosovo Tax Administration; the data for Excise Duty are taken from Kosovo Customs; whereas, the new introduced tax on real estate data are taken from Department of Property Tax and transfer on vehicles the information's are received from Department of Vehicle Registration. The information that are used are reliable and according to those information are made the scenarios forecasts for how much more revenues will have for Kosovo Budget if the government decide to apply any of those scenarios.

Chapter 1. Historic of the Tax System in Kosovo

Kosovo after the war did not have established any institution and new institutions had to be created for leading different sectors of Kosovo¹. To help Kosovo in its development, peace building, stability and self-government, the United Nations Interim Administration Mission in Kosovo (UNMIK) was authorized by United Nations Security Council in 1999. To achieve each one of those objectives UNMIK set four pillars to deal with certain sectors, while Pillar IV was for Economic Development², which is related with this paper. It is important to mention that the Kosovo government was appointed in 2002, but it was not yet set for who would take the responsibility for fiscal and tax policies³. The options were the newly created Ministry of Economy and Finance (MEF) of the Central Fiscal Authority⁴ and Pillar IV.

The revenue in Kosovo is collected in three administrative levels that include the central level, regions and municipalities. The sources of the revenue in Kosovo were the Presumptive taxes, Value Added Taxes (VAT) on domestic and imported goods, excises, custom taxes, and other taxes⁵. Kosovo relies heavily on imports collected at the border. Of non-donor revenues collected, border taxes accounted for 90 per cent of revenues collected in 2000. This reliance has decreased somewhat with the percentage falling to 70 per cent in 2004 and fall slightly further in 2005. This reliance on border taxes is high by international standards and reflects the large external imbalance in the Kosovo economy⁶.

Domestic revenues have increased from a zero base in 1999, with new domestic taxes such as profit tax, presumptive tax, VAT and personal income taxes having been introduced. From 2005 a new income tax has been induced that will further expand the base of domestic taxes⁷.

Municipalities in Kosovo collect and receive own-source revenue, including traffic fines, administration fees, royalties on mining (shared with central government) and property tax. The base of these revenues and the effectiveness of collection have been relatively low. There has

¹ <http://www.oecd.org/dataoecd/12/52/34993208.pdf>

² <http://www.unmikonline.org/archives/euinkosovo/uk/about/about.php>

³ <http://www.oecd.org/dataoecd/12/52/34993208.pdf>

⁴ <http://www.oecd.org/dataoecd/12/52/34993208.pdf>

⁵ <http://www.oecd.org/dataoecd/12/52/34993208.pdf>

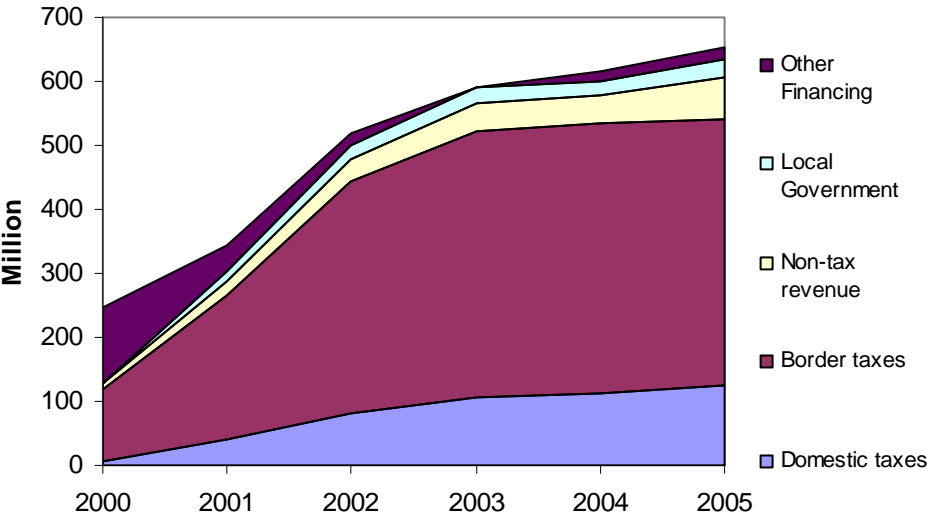
⁶ Ministry of Economy and Finance . 2005. MEDIUM TERM BUDGET FRAMEWORK: BUDGET STRATEGY 2006 –2008

⁷ Ministry of Economy and Finance . 2005. MEDIUM TERM BUDGET FRAMEWORK: BUDGET STRATEGY 2006 –2008

been only limited growth in own-source revenue compared to other types of revenue and municipalities are heavily reliant on grants from the central government. Substantial work has gone into implementing a system of property tax in municipalities and this has offered the greatest scope for growth in municipal own-source revenue. Municipalities have been actively seeking means to expand the base of Own Source Revenues and to improve collections⁸.

In the period of 2000 to 2003 total revenue collected in Kosovo more than doubled (including donor budget support), growing from less than 250 million euro in 2000 to almost 600 million euro in 2003⁹.

Figure 1.1 Revenue Trends 2000 to 2005 for Kosovo



According to Sigma Balkans Report (2002) the Revenue collected in Kosovo in 2001 was 16.4 percent of GDP, while the highest taxes were collected at the border (82 percent of total Revenue) as it can be seen in the table below¹⁰.

⁸ Ministry of Economy and Finance . 2005. MEDIUM TERM BUDGET FRAMEWORK: BUDGET STRATEGY 2006 –2008

⁹ Ministry of Economy and Finance . 2005. MEDIUM TERM BUDGET FRAMEWORK: BUDGET STRATEGY 2006 –2008

¹⁰ <http://www.oecd.org/dataoecd/12/52/34993208.pdf>

Table 1.1 Central Government Revenue 2001 (in million Euros)¹¹

Direct Taxes	25.6
Presumptive Tax	25.6
Indirect Taxes	204.3
VAT on domestic consumption	9.8
VAT on imported goods	117.6
Excises	76.9
Hotel Tax	0.8
Customs, Other Taxes	61.5
Customs	47.6
Other taxes	13.9

In 2003, the competences for making tax policy and following them were transferred from UNMIK to the Ministry of Economy and Finance in the Tax Administration of Kosovo (TAK). Since then, the information data on revenue collection were more reliable and this paper will focus more on analyzing the data collection from 2003. In the table below is fiscal table from 2003 to 2010 with reviewed budget and projected till 2013.

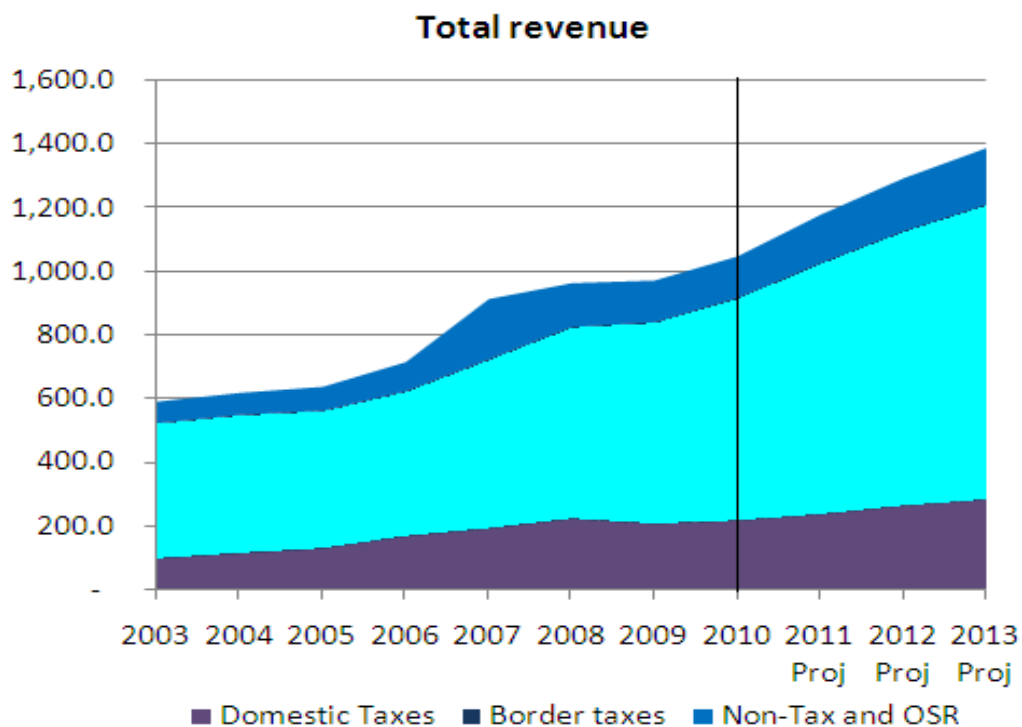
¹¹ <http://www.oecd.org/dataoecd/12/52/34993208.pdf>

Table 1.2 Budget Revenues in Kosovo (million Euros)

Description	2003	2004	2005	2006	2007	2008	2009	2010 Reviewed Budget	2011 Proj	2012 Proj	2013 Proj
TOTAL REVENUES	588.6	602.2	628.1	711.9	902.7	942.4	1,146.8	1,105.9	1,149.8	1,262.7	1,355.7
Tax Revenues	520.6	533.2	553.2	620.3	713.9	805.0	815.8	890.5	997.8	1,097.3	1,178.0
Domestic Taxes	96.8	114.2	129.0	167.3	191.8	222.0	206.4	216.1	236.0	263.1	281.9
Income tax	14.6	20.2	36.2	44.1	50.0	62.3	59.8	56.2	63.4	72.0	76.1
Profit tax	28.4	31.0	35.1	67.7	75.7	97.6	66.7	79.7	89.9	102.1	108.0
Presumptive Tax	18.9	13.1	6.7	2.3	1.0	1.3	2.8	2.0	2.2	2.5	2.7
VAT	34.9	44.8	46.4	47.7	58.8	59.0	75.8	78.4	80.5	86.8	95.0
Unspecified		5.0	4.7	5.5	6.3	1.9	1.4				
Border taxes	426.8	435.9	434.3	457.4	533.6	604.9	635.2	702.4	791.8	866.0	929.8
Customs Tax	72.3	70.6	71.9	77.7	81.2	93.3	98.3	101.2	107.1	115.8	129.7
Excise Tax	171.3	175.9	164.3	161.8	191.3	203.3	206.9	242.5	289.0	326.9	350.6
VAT	180.6	186.4	195.2	210.8	255.0	304.8	327.7	355.0	393.0	420.4	446.0
Other	2.6	3.0	2.9	7.1	6.0	3.5	2.3	3.1	3.4	3.0	3.9
Non-Tax and OSR	68.0	69.0	74.9	91.5	188.9	137.5	131.0	130.4	152.0	165.4	177.7
Non Tax	44.4	38.1	37.6	63.8	133.9	65.6	53.1	52.4	72.5	86.5	92.7
OSR	23.6	30.9	37.3	27.8	55.0	71.9	78.0	78.0	79.5	78.9	85.0
Refunds	(2.9)	(16.9)	(10.1)	(4.3)	(11.4)	(22.0)	(25.9)	(28.0)	(30.0)	(31.7)	(33.7)
Dividends							200.0	85.0	-	-	-

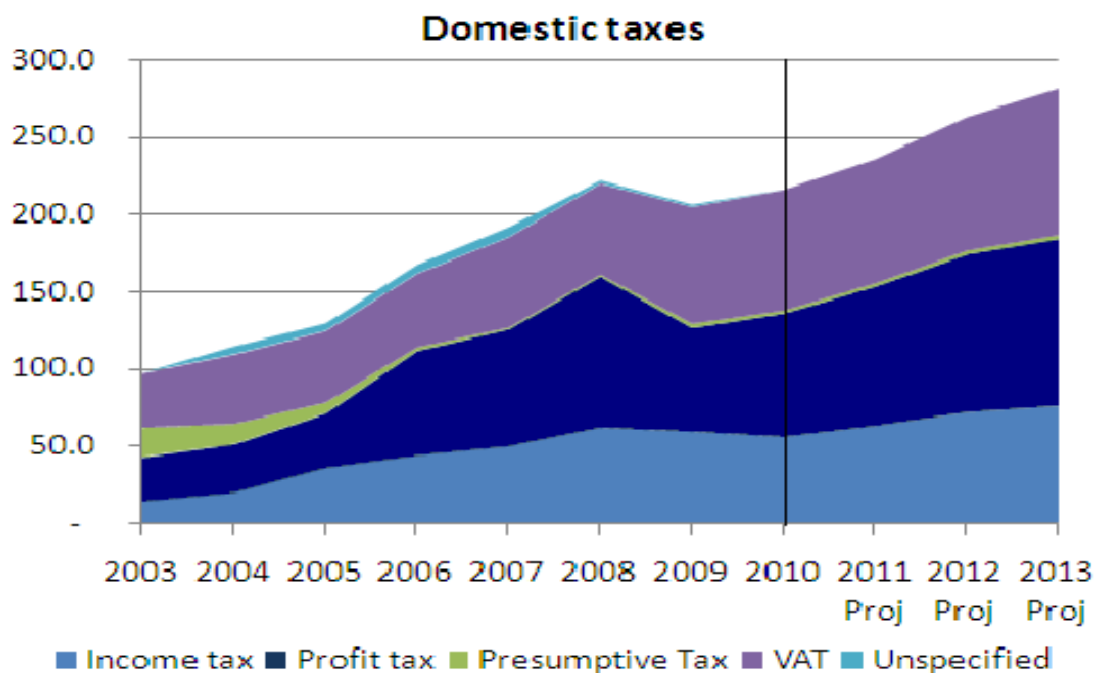
Source Macroeconomic Unit, MEF 2010

Figure 1.2 Total Revenues in Kosovo (million euros)



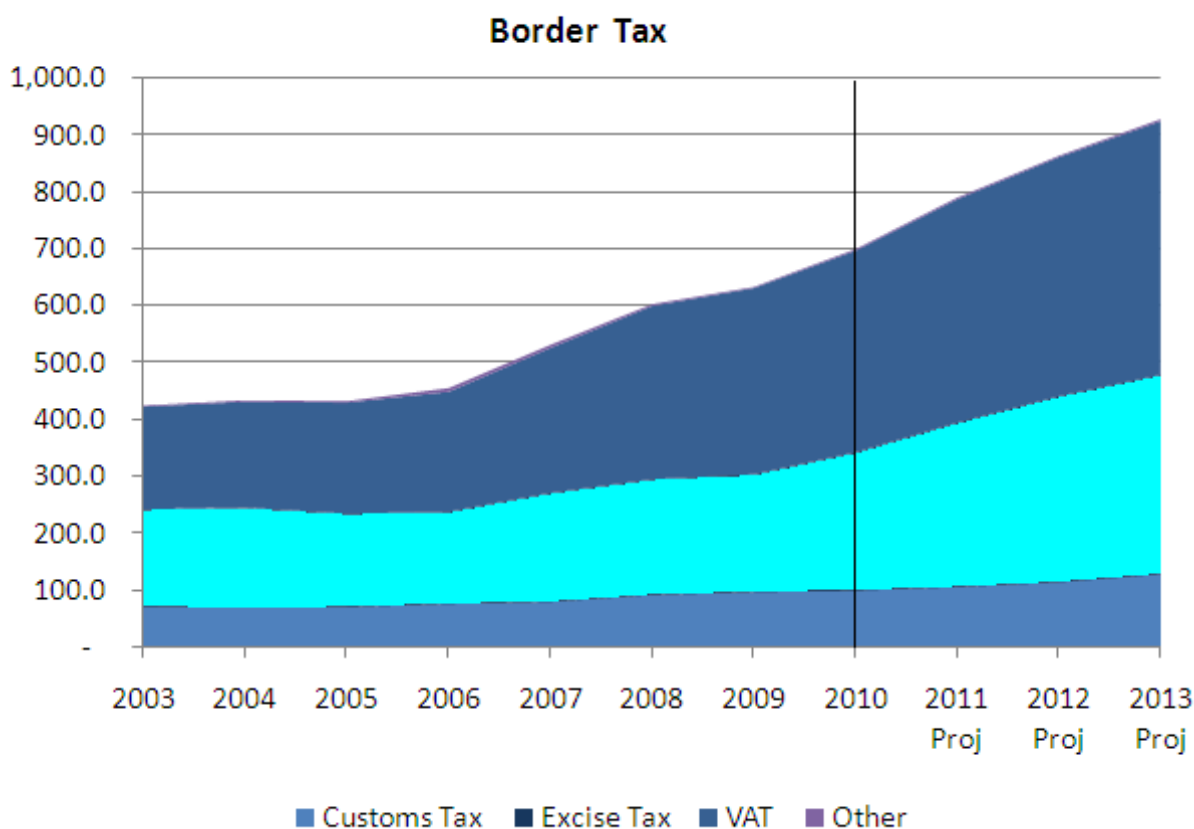
As we see the revenues are increased year by year in the beginning there was a slight increase, and from 2006 the increase of revenues were higher. The revenues in collected from domestic taxes, border taxes, non-tax revenues and one source revenue (OSR). In the graph it is shown that for each year the domestic taxes are lower than the border taxes, and on average the domestic taxes constitute about 25% of total revenue from taxes while the border taxes constitute on average about 75%. Non-tax revenue includes different fees and commission that individuals pay in governmental institutions for different services. OSR include revenues that come from different sources that are paid once, thus are not registered as regular source of revenue.

Figure 1.3 Domestic Taxes in Kosovo



Even though, the domestic taxes constitute on average only about 25% of total revenues, they are still very important for Kosovo budget. The domestic taxes include: income taxes, profit taxes, presumptive taxes, VAT and taxes that are not specified. The main sources of domestic taxes are profit taxes, VAT and income taxes. The presumptive taxes are taxes that were used more in the beginning of 2000s, and are taxes that are more common in developing countries like in the case of Kosovo, and are used to help measuring the tax base when it is difficult to measure the tax base. So, as it shown in the graph, they were important in the tax system immediately after the conflict, while their importance is decreased in the current period. The unspecified taxes make up a little portion of the domestic taxes toward the total revenues.

Figure 1.4 Border Tax in Kosovo



The border taxes are the main source of revenues collection in Kosovo, and they include customs taxes, excise taxes, and other taxes. Customs taxes are collected in the borders of Kosovo, and are applied for most imported goods at 10%. As it is shown in the graph its percentage toward the total revenues has not altered very much since 2003, but it had slight increase in current periods. Excise taxes are applied as tax on specific goods and play an important role for collection of total revenues in Kosovo borders. VAT in borders is the main source of tax collection in the border and from 2009 VAT is 16%.

As border taxes are main source for total revenues collection in Kosovo, it is important to mention the free trade agreements that Kosovo is part of. Kosovo is part of CEFTA since 2006, and it has an impact for the custom taxes. CEFTA is free trade agreement as part of the Stability Pact for South Eastern Europe in support of European Commission. The Signatory Parties of CEFTA changed since the beginning of its creation, as most of the initial parties now are part of

the EU. The current parties are “the Republic of Albania, the Republic Kosovo, Bosnia and Herzegovina, the Republic of Croatia, the Republic of Macedonia, the Republic of Moldova, the Republic of Montenegro, and the Republic of Serbia”¹². The parties’ in CEFTA have obligations toward EU and World Trade Organization. The reason why mentioning CEFTA in this research is important is because the free trade agreements specify that signatory parties are free of taxes when importing and exporting between each other. The parties of CEFTA have access to a market with 30 million consumers and it has an important role in improving the trade relations¹³.

The arguments against free trade related to this research are that the taxes collected at the borders will decline due to the fact that the signatory parties will not pay any taxes when exporting¹⁴ to Kosovo. This means that CEFTA impacts negatively the revenue collection of Kosovo, as the signatory parties do not pay any taxes. There are cases that some of these parties even dump in Kosovo as they have the free trade agreement. Furthermore, another misfortune of Kosovo is that, all the imports from signatory parties enter Kosovo as agreed in CEFTA, while Kosovo’s exports to Serbia and Bosnia and Herzegovina are blocked (Kosovo Customs). Due to this fact, Kosovo’s balance of trade is harmed and the lost revenue from custom taxes cannot be covered by the exports. Even though, the blocking of Kosovo’s exports is because of political issues the EU in cooperation with Kosovo government should punish this phenomenon, as the aim of CEFTA is for Stability Pact for South Eastern Europe with support of EU.

¹² <http://www.cefta2006.com/legal-texts>

¹³ [http://www.unmikonline.org/dpi/pressrelease.nsf/0/A183E431CBE30FB7C12572490056F188/\\$FILE/pr1623.pdf](http://www.unmikonline.org/dpi/pressrelease.nsf/0/A183E431CBE30FB7C12572490056F188/$FILE/pr1623.pdf)

¹⁴ Krugman, P and Obstfeld, M. 2005. International Economics: Theory and Policy. Seventh Edition. Publisher: Pearson

Chapter 2. Current Tax System in Kosovo

Additional budget revenues can be generated through loans or increases of tax rates. Kosovo has already started borrowing for specific large scale capital projects, and it has also inherited a substantial share of the former Yugoslav debt. To avoid the accumulation of a large stock of debt, the government will need to increase tax rates, provided that it continues to address social demands for a better public healthcare, education, and a more functional judicial system.

Considering the expansionary trend of the government's fiscal envelope, the need to generate additional budget revenues will be imminent in the medium term¹⁵, about three years. Generation of additional revenues is also important to reduce the downside risk of falling foreign direct budget support crisis, as well as the dependence on dividends from publically owned enterprises which are expected to be privatized in the near future.

The objective of this research paper is to find the expected combination of tax rate changes to generate additional revenues, whilst minimizing the additional tax burden on consumers. In addition, this paper will explore the possibilities of introducing new types of taxes in combination with changes of rates to the present taxes.

The study has adopted a technical approach to evaluate the effects of tax rate changes. First, data has been gathered from relevant institutions such as the Customs Authority and the Tax Administration¹⁶. Then, scenarios have been built using historical tax bases with assumed tax rate changes. Also, frequent reference has been made to government documents in order to check whether the proposed changes are in line with the government priorities.

Thus, the paper is more quantitative in nature, and the need for more revenues, as discussed earlier, has been assumed throughout the analysis. In the next part, however, a brief description

¹⁵ KOSOVO - Country Economic Memorandum July 2010,

¹⁶ QUARTERLY BUDGET REPORT 2010, Ministry of Economy and Finance

of the general socio-economic context, in Kosovo is presented prior to the analysis of tax rate changes and the presentation of results.

Kosovo has inherited a weak economy, and dilapidated infrastructure. The main objective of the Kosovo Government has been the creation of favorable preconditions for economic growth, mainly through increased investment in capital projects¹⁷. The government's strategic priorities have been designed to provide the basis for sustainable development in the Republic of Kosovo. During the past few years, Kosovo has seen a number of positive developments. In the economic sphere, these developments relate to tax reform, growth of capital investments and increased execution capacities for public projects. Kosovo's membership in international institutions such as the World Bank and the International Monetary Fund and the expansion and stability of the banking sector, have both contributed to the resulting positive economic growth over the past few years¹⁸.

The priorities of the Kosovo Government for economic growth have been announced to be active MEF:¹⁹

- Improvement of the transport network with special focus on national projects
- Development of power generation capacities, as a catalyst of economic growth
- Creation of a conducive and competitive environment for investment

Sustainability and changes in tax rates have been two of the main fiscal policy objectives set to fulfill government priorities. Since January 1 2009, Kosovo has introduced a package of changes in tax rates which have provided a reduction in corporate tax rate from 20% to 10%, and change in the progressive rate in personal income tax from: See table below

¹⁷ Kosovo Unlocking Growth Potential: Strategies, Policies, Actions

¹⁸ A Country Economic Memorandum April 29, 2010

¹⁹ Macroeconomic Review Jan - May 2010, Ministry of Economy and Finance

Table 2.1 The progressive rate in personal income tax

0% to 960 €per year
5% for annual wages from 961 to 3000 €
Between 3000 €and 5400 € 102 €plus 10% over 3000 €
Over 5400 euro, 342 euro plus 20% over 5400 euro

Source Law on Personal Income Tax

Table 2.2 Change in the progressive rate in personal income

The progressive rates were reduced to;0% to 960 €per year
4% for annual wages from 961 to 3000 €
Between 3000 €and 5400 € 81.6 €plus 8% over 3000 €
Over 5400 euro, 273.6 euro plus 10% over 5400 euro

Source Law on Personal Income Tax

At the same time, in order to offset losses from the reduction of these tax rates, the increase of VAT to 16% was approved, as compared to the previous 15% rate. At the same time, excise on tobacco imports has increased from €17 to €21 per unit²⁰. It should be noted that this plan is very dependent on the demand of import volumes.²¹

Improved revenue performance however, is also largely affected by external factors such as the level of inflation and real sector developments in the global economy. The longer term structural challenge is to bring about a permanent shift in the relative contribution made by the domestic economy.

Given that the need for increasing budget revenues and the fact that this is an imminent requirement, this research is focused on the possibility options for additional revenues to finance current and future capital projects, which in turn will expand the tax base in the future, and thus generate additional tax revenue.

The latest trends of fiscal policy in the region have come closer to requirements of the EU directives. EU directives imply that the fiscal policy imbalances to be reduced between EU

²⁰ 1000 cigarettes ore 1kg

²¹ Quarterly Bulletin Ministry of Economy and Finance 2010,

countries. At the same time, it is a goal of the Government of the Republic of Kosovo to gradually apply such European standards in Kosovo in order to approximate the tax legislation with EU countries.

Taking into consideration the level of economic development in Kosovo, the need for new private investment in the economy, of course should be, preceded by a good infrastructure. There is a need for additional capital investment, without neglecting the much needed social policies based on the current situation. Hence, the higher budget revenues are instrumental in fulfilling these additional capital investments, as well as the needed social policies. Since during 2009, expenditures were higher than revenues, it suggests that the expenditures in the following years need to be matched by more revenues or lower public expenditure. The Government, despite cutting the public expenditures, has to do some changes on existing tax and also introducing new taxes, not only for those needs but also to be in line with the EU and regional countries.

These revenues, of course, could be financed by loans or tax rises. Nevertheless, Kosovo has already started taking loans for certain big projects. However, to avoid a large debt-to-GDP ratio we need to eventually follow the loans by raising taxes. Taking into account that the need for increase the budget revenues has already become imminent, this research will conduct the best 'opportunities' to increase budget revenues for the next year.

To achieve this goal, special attention has been given to interventions in parts of the current fiscal legislation especially in excise and VAT increases. Therefore, the scenarios of different changes in sets of taxes and their potential expected additional revenues which they would bring are shown below for each time period.

Chapter 3. Changing the Value Added Tax in Kosovo

3.1 The scenarios with increasing VAT

There is brief description of the projected revenues if the VAT rates are increase and the three scenarios High scenario, increasing VAT rate 4%; Medium scenario increasing VAT rate by 2%; and Low scenario increasing VAT rate by 1%.

Table 3.1 Increasing VAT rate from 16% to 17%, 18% and 20%

VAT Rate	Revenue from VAT	Revenue Increase
16%	428.69	
17%	455.48	26.79
18%	482.28	53.59
20%	535.86	107.17

Source tax administration and Kosovo Customs

Increase VAT Rate from 16% to 17% would increase revenues by € 26.79 million.

An increase of the VAT Rate from 16% to 18% would increase revenues by € 53.59 million.

And an increase of VAT rate from 16% to 20% would increase revenues for € 107.17 million.

3.2 Differentiation of VAT

Table 3.2 High scenario Increasing standard rate from 16% to 20% and reduced rate to 10%

VAT Rate	Income from VAT Rate (million euro)	Increased Incomes (million euro)	Losses from reduced norms on bread, milk, oil sugar, supply of electric energy and drinking water	Net increase of incomes
20%*, 10%**	535.86	107.17	22.26	140.93

Source tax administration and Kosovo Custom

Note: *Commodity in standard rate from 16 to 20%

** Commodity under reduced rate 10%

An increase in the VAT rate from 16% to 20% will be added revenues projected to 107.17 million, but 22.26 million would have losing's by reducing the rate of 10%, which means that the projected net income will increased to €140.93 million

Table 3.3 Medium scenario Increasing standard rate from 16% to 18% and reduced rate to 9%

VAT Rate	Income from VAT Rate (million euro)	Increased Incomes (million euro)	Losses from reduced norms on bread, milk, oil sugar, supply of electric energy and drinking water	Net increase of incomes
18%,* 9%**	532.69	104.00	20.01	83.98

Source tax administration and Kosovo Customs

Note: *Commodity in standard rate from 16 to 18%

** Commodity under reduced rate 9%

An increase in the VAT rate from 16% to 18% will be added revenues projected to 104.00 million, but €20.01 million would have losing's by reducing the rate of 9%, which means that the projected net income will increased to €83.98 million

Table 3.4 Low scenario Increasing standard rate from 16% to 17% and reduced rate to 7%

VAT Rate	Income from VAT Rate (million euro)	Increased Incomes (million euro)	Losses from reduced norms on bread, milk, oil sugar, supply of electric energy and drinking water	Net increase of incomes
17%,* 7%**	503.09	74.40	19.66	64.76

Source tax administration and Kosovo Customs

Note: *Commodity in standard rate from 16 to 17%

** Commodity under reduced rate 7%

An increase in the VAT rate from 16% to 17% will be added revenues projected to €74.40 million, but €19.66 million would have losing's by reducing the rate of 9%, which means that the projected net income will increased to € 64.76 million Euros.

3.3 The scenarios with VAT differentiation

3.3.1 High Scenario

Table 3.5 VAT rate increase to 20%, with a reduced rate of 10%. (2011)

	2010	2011	2012	2013
Revenue from VAT (million euro)	428.69	591.87	634	676.25
Revenue Increase (million euro)		163.18	205.3	247.56
Losses from the reduced rate from (16%) to (10%) for bread, milk, oil, sugar		8.41	9.25	10.09
Losses from the reduced rate from (16%) to (10%) for fruits and vegetables		7.02	7.69	8.36
Losses from the reduced rate from (16%) to (10%) of supply of electricity		3.87	4.33	4.8
Losses from the reduced rate from (16%) to (10%) of supply of drinking water		0.9	0.99	1.09
Net Revenue Increase Compared with 2010		142.99	183.05	223.22

Source tax administration and Kosovo Customs

An increase of VAT rate from 16% to 20% would increase the projected revenue for € 163.18 million, but € 22.26 million would be lost from reduced rate of 10%, which means that the net revenue would increase by € 142.99 million only from the increase of the VAT rate in 2011 and is projected revenues will be increasing year by year.

3.3.2 Medium Scenario

Table 3.6 VAT rate increase to 18%, with a reduced rate of 9%. (2011)

	2010	2011	2012	2013
Revenue from VAT (million euro) 16%	428.69	532.69	570.6	608.63
Revenue Increase (million euro) 18%		104.00	141.91	179.94
Losses from the reduced rate from (16%) to (9%) for bread, milk, oil, sugar		8.33	9.16	10.00
Losses from the reduced rate from (16%) to (9%) for fruits and vegetables		6.96	7.62	8.28
Losses from the reduced rate from (16%) to (9%) of supply of electricity		3.83	4.29	4.76
Losses from the reduced rate from (16%) to (9%) of supply of drinking water		0.89	0.99	1.08
Net Revenue Increase Compared with 2010		83.98	119.85	155.82

Source tax administration and Kosovo Custom

An increase of VAT rate from 16% to 18% would increase the projected revenue for € 104, 00 million, but €20.01 million would be lost from reduced rate of 9%, which means that the net revenue would increase by € 83.98 million only from the increase of the VAT rate in 2011 and is projected revenues will be increasing year by year for example in this scenario till 2013 Net revenues increase will be about double.

3.3.3 Low Scenario

Table 3.7 VAT rate increase to 17%, with a reduced rate of 7%. (2011)

	2010	2011	2012	2013
Revenue from VAT (million euro) 16%	428.69	503.09	538.90	574.81
Revenue Increase (million euro)17%		74.40	110.21	146.12
Loses from the reduced rate from (16%) to (7%) for bread, milk, oil, sugar		8.18	8.99	9.81
Loses from the reduced rate from (16%) to (7%) for fruits and vegetables		6.83	7.48	8.13
Loses from the reduced rate from (16%) to (7%) of supply of electricity		3.76	4.22	4.67
Loses from the reduced rate from (16%) to (7%) of supply of drinking water		0.87	0.97	1.06
Net Revenue Increase Compared with 2010		54.76	88.55	122.45

Source tax administration and Kosovo Customs

An increase of VAT rate from 16% to 17% would increase the projected revenue for €74.40 million, but €19.66 million would be lost from reduced rate of 7%, which means that the net revenue would increase by €54.76 million only from the increase of the VAT rate in 2011 and is projected revenues will be increasing year by year for example in this scenario till 2013 Net revenues increase will increase more than double.

As it is mentioned in the beginning as we have to follow EU standards in one side, and in other side also we have to follow the fiscal policy in region countries, researching their tax rates in this case for VAT rates we see that all countries have differentiation of VAT standard rate and other rates, and some countries had more than two rates. Also below we have and VAT threshold in the same countries, because part of this project is and lowering VAT threshold.

Concerning to VAT standard rate Kosovo has 16% and is the lowest in the region, which means that we have space to increase standard rate in one side and to introduce low rate for VAT and in

the same time to lower the threshold for VAT from € 50,000.00 to € 30,000.00 in order to increase tax base for VAT.

Table 3.8 Selected European Countries: VAT rates and Threshold

	VAT Rates			VAT Threshold
	Current Standard Rate	Other Current Rates		
Central and Eastern Europe				
Kosovo	16.0		Kosovo	50,000
Albania	20.0		Albania 3/	63,973
Bosnia and Herzegovina	17.0		Austria	30,000
Bulgaria 1/	20.0	7		
Croatia	22.0	10.0		
Czech Republic 1/	19.0	9.0		
Hungary 1/ 4/	25.0	5.0	Bosnia and Herzegovina	25,497
Macedonia	18.0	5.0	Bulgaria	25,498
Poland 1/	22.0	3.0; 7.0		
Romania 1/	19.0	5.0; 9.0		
Russia	18.0	10.0		
Serbia	18.0	8.0	Croatia	11,532
Slovak Republic 1/	19.0	10.0		
Slovenia 1/	20.0	8.5	Czech Republic	35,535
Other Selected European Countries				
Austria 1/	20.0	10.0; 12.0		
Denmark 1/	25.0 2/			
Finland 1/	22.0	8.0; 12 3/		
France 1/	19.6	2.1; 5.5		
Germany 1/	19.0	7.0	Denmark	6,693
Greece 1/	19.0	4.5; 9.0		
Ireland 1/	21.5	4.8; 13.5		
Italy 1/	20.0	4.0;10.0		
Netherlands 1/	19.0 5/	6.0		
Norway	25.0	8.0; 14.0		
Sweden 1/	25.0	6.0; 12.0		
United Kingdom 1/	15.0 6/	5.0	Finland	8,500

Sources: International Bureau of Fiscal Documentation, IBFD, www.ibfd.org (2009);
Worldwide Summaries

(PricewaterhouseCoopers), www.pwc.com (2009); http://ec.europa.eu/index_en.htm;

European Commission "Taxation and
Customs Union" (EU 2009); and country documents.

1/ European Union countries.

2/ The first sale of artists' products is subject to VAT at the standard rate of 25 percent, but only 20 percent of the taxable base is taken into account, therefore, the effective VAT rate is 15 percent.

3/ The other positive rate of 17 percent was decreased to 12 percent with effect from October 1, 2009.

4/ Effective from July 1, 2009.

5/ Under the budget 2009, the government withdrew its planned increase of the standard VAT rate from 19 percent to 20 percent.

6/ The standard rate of 17.5 percent has temporarily been reduced to 15 percent until November 2009, but if effect until December 31, 2009.

The dilemma for single rate or multiply tax rates as is stated according to Alain A. Tait Value Added Tax e The "Politicians nearly always think the public will acquiesce to a VAT more easily if products consumed by lower-income households are taxed at lower rates than products consumed by the better off" generally it is true, but in Kosovo case is different, first because of the social and economic situation high unemployment and poverty remain two of the most critical problems facing Kosovo today.

The UNDP reports says Kosovo has the highest unemployment rate in the Western Balkans around 45% of the working-age population is without a job. According to reports from the UNDP and other international organizations, about 37% of the population lives in poverty below the line of 1.42 euro's a day and over 17% lives in extreme poverty below the line of 93 euro cents a day. Another argument for applying reduced rate of VAT is to stimulate homemade production of those commodities. Generally a reduced rate applies for food and some other services.

3.4 Lowering VAT Threshold

Other possibility for VAT incomes is lowering of VAT threshold, as it is stated also in the new VAT Law which is in place from January 2010 that with amendment will be reduced also and VAT threshold with decision of ministry of Economy and Finance in transition period. In order to upraise the tax base, it is good to reduce VAT threshold on one side and on other side will reduce the informal economy.

According to calculations that are based on the data from tax administration, it is reached an assessment which is based on the number of businesses that pays VAT number of businesses that do not pay VAT those who have circulation from €30,000 to €50,000 and those who have circulation from €50,000 to €60,000. From this assessment it appears that revenues will be collected by lowering the threshold for VAT would be about €8 million.

In the table above is number of countries that are shown the VAT Threshold. As we see in this table the threshold of those countries doesn't differentiate so much taking in to the consideration neighboring countries, for example Albania has the threshold €63,973.

The VAT threshold for Macedonia is €1,100 in Serbia is €1,280 etc. But also the countries that are part of EU the threshold is much lower. Kosovo has the Vat Threshold €50,000 which means is somewhere in between region countries, but in order to be in line with European Directive has to take those steps as it is differentiation of VAT and lowering the threshold for VAT.

Chapter 4. Excise tax on luxury goods

4.1 Increase of Tobacco Excise duty

The table below provides an overview of proposed increase in tobacco excise duties from 21€ to 25€, 35€ or 50€ per unit.

Table 4.1 Revenues for tobacco excise scenarios from 21 existing rate to 25, 35 or 50 €

2009						
Excise	Quantity in kg.	Customs base	Customs duty	Excise	VAT	TOTAL
21 Euro	2,833,363.67	38,401,470.16	3,840,147.02	59,500,637.07	16,278,760.68	79,619,544.77
25 Euro	2,748,834.98	37,255,826.31	3,725,582.63	68,896,543.22	17,580,472.35	90,202,598.19
35 Euro	2,536,332.68	34,375,716.06	3,437,571.58	92,342,627.57	20,824,946.45	116,605,145.59
50 Euro	2,217,579.23	30,055,550.68	3,005,555.07	110,878,961.33	23,030,410.73	136,914,927.13

There are three scenarios low, medium, and high. The first scenario is an increase with €4, the second €10 and the third an increase with €29.

These data²² indicate that if an increase of 4€ per unit in tobacco excise duties is affected, there will be an increase of around €1.75 Million. An increase of €10 would yield €37 Million of additional revenue and increase of about triple €29 would yield €7.00 Million, which means we would have five times more revenues.

The following provides an overview of excise duties in EU and countries of the region. It is not possible to make an adequate comparison as excise duties vary country to country e.g. Serbia with its new rules applies excise duty under a specific tax along with proportional, EU applies specific and value added tax, and even inside the EU there are countries with a high excise duty on tobacco. With respect to neighbouring countries, Albania has a lower duty than Kosovo while in Macedonia it is set at €22 per kg, meaning only €1 per kg. (See Table 4.2 for rates in the region).

²² The calculation in table 1 considers a fluctuation in demand for tobacco of around -0.3

Table 4.2 Retail price in EU and region countries

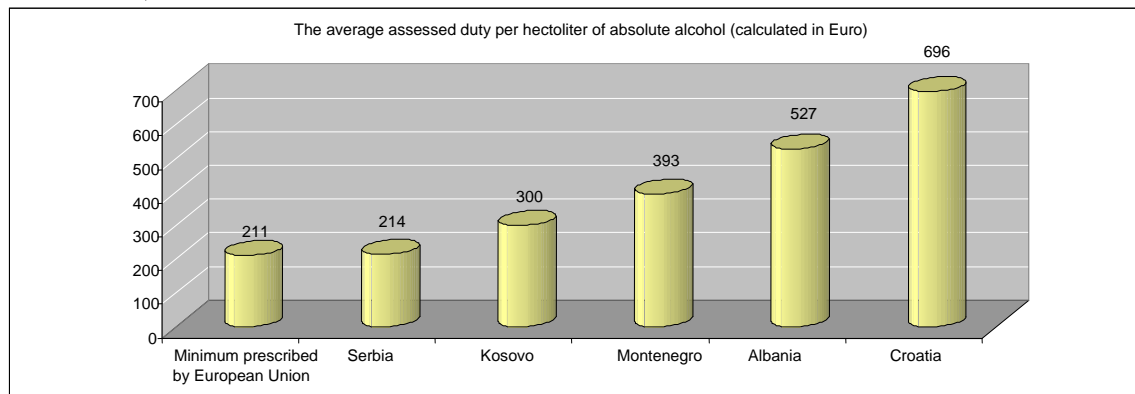
	Specific tax per box	Proportional tax per box
Serbia	8.92 €(2009)	38%
	13.32 €(2010)	39%
	14.2 €(2011)	40%
	14.97 €(2012)	42%
EU specific and value added	64€/per 1000 cigarettes + 58.99 value added	
Montenegro	15€/kg + 26% value added	
Macedonia	22€/kg	
Slovenia	69€/per 1000 cigarettes + 58.72 value added	
Bulgaria	76€ per 1000 cigarettes + 72.03 value added	
Albania	15.86/€/kg	
Kosovo	21 /€/kg	

1000 cigarettes or 1Kg

4.2 Increase of Excise Duty for alcohol beverages

The rate of excise duties in Kosovo for alcohol is € 300 per hectolitre of absolute alcohol, irrespective of type of beverage containing the pure alcohol. In many other countries, the excise varies depending on the quantity of produce, type of beverage and certain discounts on specific beverages. Therefore, the rates of excise duties as set out in other countries laws are not directly comparable to those in Kosovo. For this reason, proper calculations have been done to convert all these norms into the same quantity and quality of alcohol, weighing them against the types of alcoholic beverages consumed in Kosovo and by converting them all in Euro (depending on the exchange rate of respective currencies), which provides basis for calculation of the average excise duty in Euro. This is presented in Chart4.1 In other words; Chart 4.1 indicates the amount excise duties payable in Euros payable per hectolitre of pure alcohol.

Figure 4.1 Hypothetical application of alcohol excise duty rates from other countries to Kosovo (€per hectoliter)



As seen in Figure 4.1 above, in average only Serbia charges less excise duty for alcohol. Most of other countries have higher average of excise duty than Kosovo.

Below are the tables for some countries for making comparison. There are different tables for different countries because of different policy on excise tax.

Table 4.3 Croatia excise duty for alcohol

Excise product	Excise duty base	Amount of excise duty
Beer	1 % of pure alcohol in one hectoliter of the finished product	5.41
Still and sparkling wines	one hectoliter of the finished product	€0,00
Other beverages obtained by fermenting other than beer and wine	one hectoliter of the finished product	€0,00
Excise duty on intermediate products containing less than 15% vol of pure alcohol	one hectoliter of the finished product	67.61
Intermediate products containing 15 % vol of pure alcohol or more	one hectoliter of the finished product	108.18
Ethyl alcohol	1 hl of pure alcohol expressed as volume percentage measured at 20° C	716.71

Source: http://www.porezna-uprava.hr/en/porezi/v_poreza.asp?id=b01d1

Table 4.4 Serbia excise duty for alcohol

Ethyl Alcohol (Ethanol)	
-Denatured fuel alcohol	0.10 €M€€
-Alcohol used for the production of alcoholic beverages and cosmetics	0.31 €hl
-Alcohol sold to pharmacies, hospitals stores and other end-users	0.20 €hl
-Alcoholic beverages:	
-Beer	0.08 €lit
-Natural Brandi and vinjak	
-Spirits and other alcoholic beverages other than whiskey ,gin and cognac	0.61 €lit
-Whiskey, gin and cognac	0.92 €lit

Source: <http://www.carinskatarif.com/english/Tekstovi/AKCIZE.HTM>

Table 4.5 Montenegro excise duty for alcohol

- 1,90 Euro per volume content of alcohol in the hectoliter of beer;
- »0« (zero) Euro per hectoliter of table wine;
- 35 Euro per hectoliter of sparkling wine;
- 40 Euro per hectoliter of other fermented beverages;
- 70 Euro per hectoliter of medium alcohol beverages;
- 550 Euro per hectoliter of pure alcohol.

Source: <http://www.gov.me/files/1192438155.pdf>

Table 4.6 Albania excise duty for alcohol

<p>For Chapter: 2203 - "beer" Tax law provides differentiated, depending on the amount of annual production from domestic and foreign manufacturers (0.21 €/ liter for the quantity <= 200 000 hl / year and 0.28 €/ liter for the amount > 200 000 hl / year).</p>
<p>For Chapter: 2204 - "Wine and sparkling wines, champagne, wine grapes," Lower tax law provides differentiated, depending on the amount of annual production from domestic and foreign manufacturers (0.21 €/ liter for the quantity <= 1 000 hl / year and 0.25 €/ liter for quantities > 1 000 hl / year).</p>
<p>For Chapter: 2205 - "Vermouth the other wines prepared from plants or aromatic substances," Lower tax law provides differentiated, depending on the amount of annual production from domestic and foreign manufacturers (0.14 € / liter for the quantity <= 300 hl / year and 0.24€/ liter for quantities > 300 hl / year).</p>
<p>For Chapter: 2208-“Alcohol beverages with alcohol strength by volume over 12 percent ,”Lower tax law provides differentiated depending on the amount of annual production from domestic and foreign manufacturers . (1.05 €/ liter for the quantity <= 20 000 hl / year and 1.4 €/ liter for quantities > 20 000 hl / year). All entities that will import.</p>

Source:<http://www.dogana.gov.al/doc/Udhezim07.pdf>

The shift to flexibility in the excise duty rates levied on alcohol and alcoholic beverages, intermediate products, wine and beer involves setting the following minimum rates:²³

- ECU 0.748 per hectoliter/degree Plato or ECU 1.87 per hectoliter/degree of alcohol for beer;
- ECU 0 per hectoliter for wine;
- ECU 45 per hectoliter for intermediate products;
- ECU 550 per hectoliter of pure alcohol for alcohol and alcohol contained in other beverages.

For the last-mentioned category, Member States which apply a rate of duty exceeding ECU 1 000 per hectoliter of pure alcohol may reduce it but not below ECU 1 000.

For the same category, Denmark and Italy were allowed to maintain their existing tax

²³ http://europa.eu/legislation_summaries/taxation/l31024_en.htm

arrangements until 30 June 1996 provided that their rates did not fall below the minimum rate lay down.

Reduced rates may be applied in certain regions of Greece, Italy and Portugal (see the 'Related Acts' section below).

Every two years, the rates of duty are reviewed and any necessary adjustments made, the first review having been made on 31 December 1994.

This allows room for raising the excise duty on alcoholic beverages in Kosovo. An increase from 300 Euros per hectolitre of alcohol to 400 Euros per hectolitre of alcohol (HPA) would approximate Kosovo to many countries in the region. Additionally, an increase of excise duty from 300 to 400 Euros per hectolitre of absolute alcohol is projected to generate around 1 million Euros more annually for the budget of the Government of Kosovo.

Revenues from excise duties on alcoholic beverages in 2009 were about 3.5 million Euros. Of this, 2.4 million Euros were excise duties on beer, while the rest from other alcoholic beverages, mainly liquor (837 thousand) and wines (231 thousand). See Table 2 for details.

Table 4.7 Kosovo Revenues from excise duties on alcohol

Alcohol by Customs Code	Excise revenues
Beer (2203)	2,402,625.00
Grape Wine (2204)	231,432.00
Other Wine (2205)	2,835.00
Other (2206)	2,883.00
Ethyl alcohol in excess of 80% (2207)	31,924.50
Liquors...(2208)	836,566.04
Total	3,508,265.54

Sources Kosovo Customs

Table 4.8 The scenarios

	Excise rate	Project excise revenues
Current excise duty	300 euro per hectolitre	3.5 million
Low scenario	400 euro per hectolitre	4.4 million ²⁴
Medium scenario	500 euro per hectolitre	5.5 million ²⁵
High scenario	600 euro per hectolitre	6.5 million ²⁶

As the VAT is only calculated after application of excise, an increase of 1.1 Million Euros in excise revenues would yield an increase of more than 160,000 Euros of VAT revenues. Therefore, an increase from 300 to 400 Euros per hectolitre would increase the revenues for around 1.26 Million Euros under assumption that this change will not exacerbate the fiscal evasion.

As favourable as the increase of excise duty from 300 to 400 Euros per HPA may be, there is still room for an increase to 600 Euros per HPA. However, there are sound reasons to limit the increase to 550 Euros as this would be the highest excise in the region leading to a lucrative alcohol smuggling activity and fiscal evasion. On the other hand, unchanged excise duty of 300 Euros per HPA may not fully avail of the potential to enhance the revenues. Hence the increase from 300 to 400 Euros is more appropriate.

Although several countries of the region have exempted the wine from payment of excise duties in view of its status as the table beverage (drunk during meals), this exemption may not be equally justified in Kosovo, as the wine does not enjoy the same status in most Kosovo families. This may only apply to certain international individuals, who have a better buying power, which in itself does not constitute a viable reason for exemption, while excise duties are applied to beer and other alcoholic beverages in line with the percent of alcohol they contain.

Therefore, a raise of excise duties for alcoholic beverages will not only enhance revenues but also protect the health of our citizens. This policy will not only raise revenues but also decrease additional health care costs for the government.

²⁴ Having in mind that the liquor excise is at approximately 28% of the customs basis, an increase of excise for 33% shall result in an increase of liquor prices for averagely 9%. Based on a widely accepted elasticity of the liquor demand, which is at -0.4%, in that case an increase of liquor prices for 9% shall result in a decreased quantity of consumed liquor for averagely 3.6%. This calculation has been taken into consideration to calculate the Table4.1

4.3 Change of Excise Duty for Vehicles

4.3.1 Current situation

The current excise duty for vehicles levied at customs during the import of vehicles is 500 Euros per vehicle. Also, the limit to age of vehicle that may be imported to Kosovo is 8 years.

Table 4.9 Situation in 2009

Age	Vehicle assessment at time of import	Custom duty 2009	Excise duty 2009	Value 2009	VAT 2009	Total average of revenues per vehicle	Number of imported vehicles (assessment)	Total revenues
8	3,421	342	500	4,263	682	1,524	2625	4,001,228
7	4,277	428	500	5,204	833	1,760	2450	4,312,849
6	4,277	428	500	5,204	833	1,760	2187.5	3,850,758
5	5,987	599	500	7,086	1,134	2,232	2012.5	4,492,876
4	5,987	599	500	7,086	1,134	2,232	1575	3,516,164
3	8,553	855	500	9,909	1,585	2,941	1312.5	3,859,659
2	8,553	855	500	9,909	1,585	2,941	1050	3,087,728
1	11,119	1,112	500	12,731	2,037	3,649	962.5	3,512,067
0	11,975	1,197	500	3,672	2,188	3,885	1013	3,935,475
Total								34,568,803

In 2009 the import of vehicles generated 34,568.803 meaning 4,963,998.99 more than 2008, including the customs duty, excise and VAT from both new and second-hand vehicles. While the amount of new imported vehicles is 1013 and second hand imported vehicles is 14125, which means that the import of second-hand vehicles is more than ten times higher than new vehicles. This indicates that the import of second-hand vehicles is dominant and therefore in view of the clear preference for second-hand vehicles and the goal of increased revenues, the following provides an overview of scenarios for extending the age of imported vehicles and raise the excise based on age and engine cubic volume.

4.3.2 Analysis Scenarios

In order to achieve a more balanced distribution of tax load on various vehicle owners depending on the impact on environment and traffic in Kosovo, several similar scenarios are presented along with revenue forecasts for each of these scenarios.

Scenario 1.

Table 4.10 The assumption that the allowed vehicle age is 8 to 10 years would bring 3000 vehicles more per year. No changes to excise duties.

Age	Price at time of import (assessment)	Custom duties	Excise	Value	VAT	Total average revenue by vehicle	Number of imported vehicles (assessment)	Total revenues
10	3000	300	500	3,800	608	1,408	2550	3,590,400
9	3500	350	500	4,350	696	1,546	2465	3,810,890
8	3,421	342	500	4,263	682	1,524	2295	3,498,216
7	4,277	428	500	5,204	833	1,760	2125	3,740,736
6	4,277	428	500	5,204	833	1,760	1870	3,291,848
5	5,987	599	500	7,086	1,134	2,232	1955	4,364,508
4	5,987	599	500	7,086	1,134	2,232	1275	2,846,418
3	8,553	855	500	9,909	1,585	2,941	935	2,749,548
2	8,553	855	500	9,909	1,585	2,941	850	2,499,589
1	11,119	1,112	500	12,731	2,037	3,649	765	2,791,409
0	11,975	1,197	500	13,672	2,188	3,885	1013	3,935,475

Total **37,119,037**

The assumption that the allowed vehicle age is 8 to 10 years would bring 3000 vehicles more per year and with no changes to excise duties, revenue increase of 2.5 million Euros is projected.

Scenario 2

Table 4.11 The assumption that the allowed vehicle age is 8 to 10 years would bring 3000 vehicles more per year. Moderate raise in excise duty

Age	Price at time of import (assessment)	Custom duties	Excise	Value	VAT	Total average revenue by vehicle	Number of imported vehicles (assessment)	Total revenues
10	3000	300	1,100	4,400	704	2,104	2550	5,365,200
9	3500	350	1,100	4,950	792	2,242	2465	5,526,530
8	3,421	342	900	4,663	746	1,988	2295	4,563,096
7	4,277	428	900	5,604	897	2,224	2125	4,726,736
6	4,277	428	900	5,604	897	2,224	1870	4,159,528
5	5,987	599	700	7,286	1,166	2,464	1955	4,818,068
4	5,987	599	700	7,286	1,166	2,464	1275	3,142,218
3	8,553	855	700	10,109	1,617	3,173	935	2,966,468
2	8,553	855	500	9,909	1,585	2,941	850	2,499,589
1	11,119	1,112	500	12,731	2,037	3,649	765	2,791,409
0	11,975	1,197	500	13,672	2,188	3,885	1013	3,935,475
Total								44,494,317

Scenario 2. The assumption that the allowed vehicle age is 8 to 10 years would bring 3000 vehicles more per year and with moderate raise in excise duty this scenario would generate 9,9 million Euros more.

Scenario 3.

Table 4.4 Increase of excise duties by age and engine cubic volume.

		Age (years)						
		0	1 - 4	5 – 8	9 – 12	13 –16	17- 25	over 25
Cubic volume	Up to 1600	0	300	600	1400	2200	3100	4000
	1601-2000	200	600	900	1800	2600	3500	4400
	2001-2500	400	1000	1300	2200	3000	3900	4800
	2501-3000	700	1400	1700	2600	3400	4300	5200
	3001-3500	1000	1800	2100	3000	3800	4700	5600
	Over 3500	1300	2200	2500	3400	4200	5100	6000

The rate of excise duty in Scenario 3 have been attained based on an exponential increase of excise duty by age and a linear increase of excise rate by engine cubic volume. This was done to discourage the import of very old vehicles in Kosovo, where vehicles older than 17 years are charged a very discouraging excise for purchase of these vehicles. Similarly, the rate of excise duty is increased by engine cubic volume in order to discourage vehicles with poor fuel economy for environment protection purposes and traffic alleviation. For illustration of proposed scenarios the effect raises on vehicles by price, age and engine cubic volume.

Revenues forecast under this scenario:

In order to make an assessment of revenues under this scenario, there are several reasonable assumptions as it is difficult to assess the types of vehicles that will be imported (by age or cubic volume) if the 8 years limit is lifted. According to the European Environmental Agency, the average age of vehicles in 1998 was 7.2 years and growing²⁷. Also the same study shows that there is a negative correlation between the GDP per capita and the average age of vehicles. Consequently, an increase of the average age of vehicles in Kosovo is expected. It is also

²⁷http://ims.eionet.europa.eu/Sectors_and_activities/transport/indicators/TERM33,2001/Average_age_of_the_vehicle_fleet___TERM_2001.pdf

reasonable to suppose from the daily practice that the distribution of vehicle age frequency follows the Poisson distribution. This means that there are few new vehicles in Kosovo but the higher the age the more vehicles there are in Kosovo until certain limit, when the number starts dropping again. With respect to the cubic volume, the distribution is based on data from Department of Vehicle Registration in the Ministry of Interior as well as data on import of new and old vehicles. These served to acquire specific weight of the number of vehicles by age and cubic volume, in order to calculate the excise for each classification separately, as outlined in the table below.

Table 4.5. Revenues from combined revenues by cubic volume and age

	Number of vehicles	Price at import	Aggregate value	Aggregate customs	Aggregate excise duty	VAT	Revenues
Excise on age							
0	700	12,000	8,400,000	840,000	0	1,386,000	2,226,000
1 to 4 years	4,000	10,000	40,000,000	4,000,000	600,000	7,136,000	11,736,000
5 to 8 years	5,400	4,000	21,600,000	2,160,000	1,620,000	4,060,800	7,840,800
9 to 12 years	4,300	3,000	12,900,000	1,290,000	3,010,000	2,752,000	7,052,000
13-16 years	2,700	2,000	5,400,000	540,000	2,970,000	1,425,600	4,935,600
Over 17	900	1,000	900,000	90,000	1,395,000	381,600	1,866,600
							<u>35,657,000</u>
Excise on cubic volume							
Up to 1600	4,000	800	3,200,000	320,000	0	563,200	883,200
Up to 2000	9,000	1,000	9,000,000	900,000	100,000	1,600,000	2,600,000
2001-2500	2,769	2,000	5,538,000	553,800	400,000	1,038,688	1,992,488
2501-3000	700	3,000	2,100,000	210,000	1,050,000	537,600	1,797,600
3001-3500	372	4,000	1,488,000	148,800	2,000,000	581,888	2,730,688
Over 3501	1,159	10,000	11,590,000	1,159,000	6,500,000	3,079,840	10,738,840
							<u>20,742,816</u>
Total revenues							56,399,816

Total projected revenues under this combined scenario involving age and cubic volume is 56.4 million Euros, meaning an increase of **21** million Euros. However, this estimate is based on the assumption that the demand for vehicles will not change after the introduction of new excise duty. It may happen that this new type of excise will encourage the purchase of new vehicles compared to second-hand, which would result in an increase lower than 21 million Euros, which would anyhow result a even a nominal increase.

It is noteworthy that a significant number of second-hand vehicles imported in Kosovo may not meet the requirements of counter parting test.

Chapter 5. Tax on transfer of real estate and vehicles

The legislation of the Republic of Kosovo allows for expanding the tax base by introducing new taxes already applied in most of regional and EU countries. One of such taxes is the tax for transfer of real estate and vehicles. These transactions in Kosovo, under the VAT legislation, is exempted meaning that these transactions are not subject to any taxes, while in other countries these transactions are not only subject to VAT but also the tax on transfer of ownership, the rate of which usually varies from 2.5% to 5% (see Table 5.1)²⁸

Table 5.1 Additional taxes on residential property

Belgium	21% VAT instead of Transfer Duty (12.5% in Brussels and Wallonia, 10% in Flanders)
France	19.6% VAT (plus €125 or reduced registry fee of 0.715% for properties off plan) instead of 5% Registration Fees
Greece	19% VAT is paid instead of transfer tax (7% - 11%)
Hungary	20% VAT.
Italy	VAT (plus fixed registration tax of €168) is levied instead of registration tax (3% or 7%) 4% VAT for first home resident buyers 10% VAT for second-home and non-resident buyers 20% VAT for luxury homes
Latvia	18% VAT
Lithuania	18% VAT
Macedonia	18% VAT
Monaco	20.6% VAT instead of 6.5% registration fee
Montenegro	17% VAT instead of 2% Transfer Tax
Netherlands	19% VAT instead of 6% Transfer Tax
Poland	7% VAT instead of 2% Civil Transaction Tax
Serbia	8% VAT instead of 5% Transfer Tax
Slovakia	23% VAT
Slovenia	8.5% VAT (Apartments intended for rental: 20% VAT) instead of 2% Transfer Tax
Spain	7% VAT (plus 0.5% or 1% Stamp duty) instead of 7% Property Transfer Tax
Ukraine	20% VAT

Therefore there are proposed the introduction of a 2%, 3% and 5% tax on transaction of real estate and vehicles in order to generate more revenues at central level.

²⁸ Source: [Global Property Guide](#) research, contributing accounting firms and government agencies

5.1 Tax on real estate transactions

If the proposed 2% low scenario, Medium scenario 3% or high scenario 5% tax on real estate transactions is introduced, the following are revenue projections

Table 5.1 Revenues from tax on transfer of ownership

The number of real estate transactions (estimated)	11037
Average value of transaction (estimated)	40000
Total transactions value	441,480,000.00
Low scenario 1: revenues from 2% tax on transactions	8,829,600.00
Medium scenario 2: revenues from 3% tax on transactions	13,244,400.00
High scenario 3: revenues from 5% tax on transactions	22,074,000.00

Under the first scenario, featuring a 2% tax, the revenues would be increased for an estimated 8.8 million Euros. Under the second scenario, at 3% tax, the revenue would be increased for an estimated 13.24 million and 5% tax the revenues would be 22.07 million euro

5.2 Tax on vehicle transaction

Table 5.2 Revenues from vehicle transactions

Number of vehicle transactions	55,700.00€
Average value per transaction	1,500.00€
Total value of transactions	83,550,000.00 €
Law scenario 1. Revenues from 2% tax	1,671,000.00€
Medium scenario 2. Revenues from 3% tax	2,506,500.00 €
High scenario 3. Revenues from 5%	4,177,500.00€

Based on information received from Department of vehicle registration, the transactions exceed 55.7 thousand Euros annually; if the average transaction value is 1,500.00€ then the taxation base for transaction of vehicles would be $55,700 \times 1,500 \text{ €} \times 2\% = 1,671,000.00 \text{ €}$ The same amount with 3% would be 2,506,500 € and with 5% will be 4,177,500.00

The estimations above indicate that both types of transactions (real estate and vehicles) may generate revenues for the first scenario with if 2% tax rate is applied, revenue forecast will be 10.5 million Euros for the second medium scenario with a tax rate of 3% the revenue forecast will be 15.6 million Euros and with the high scenario 5% the revenue forecast will be 26.25 million Euros

The tax on transaction is applied in countries of the region but also in some EU countries such as Czechoslovakia. The transaction tax is usually paid by the seller.

Chapter 6. Final discussions and Recommendations

The research is focused on making scenarios on some of the taxes that are considered to have space for making changes and without so much change in tax system and at the same time to protect the welfare of society. To achieve this goal, great importance has been given to intervention in some parts of fiscal legislation that are in force and setting the fiscal package of new taxes in Kosovo that are still not applied. After considering a wide range of possibilities for application of the new taxes, this research proposes to tax the transfer of ownership of real estate and motor vehicles, to be the next new tax, due to budgetary revenues that promises, not causing large effect on the application of existing taxes.

The VAT scenarios are made for increasing revenues and, to assess the reflection of budget losses. There are some advantages and disadvantages for applying VAT differentiation. There are three scenarios for VAT differentiation: low, medium, and high. The first scenario is standard rate from 16% to 20%, second 18% and 9% and third 17% and 7%.

Concerning the economic situation of Kosovo from all three proposed scenarios the best is the low scenario that increases the standard VAT rate from 16% to 17% and the low rate 7%.

Revenues and benefits for those scenarios are summarized below. This scenario will bring net revenues from VAT in amount of €Million 54.76 in 2011 compared to 2010, and the projected revenues will be increasing year by year. Furthermore lowering threshold from 50,000 to 30,000 euro will bring about €million 8 based on Customs and Fiscal Assistance Office (CAFAO) Cost and benefit analysis.

The third scenario is more appropriate to apply for many reasons:

6.1 Advantages of VAT increase

Primary increasing standard rate from 16% to 17% and introducing the different rate for essential products to 7% is a good step for the leaving standard for the population and does not affect too much in prices. The calculations of the CPI show that the prices of this scenario do not increase

the prices, while it shows that it will have a slight decrease of the consumption prices. In this case we do not expect too much negative reaction from the society, since the essential goods will become cheaper and VAT does not increase by large percentage.

Secondly, this scenario is a step forward to applying a new law so that Kosovo will be in line with EU standards and VAT Directive. The current VAT law which is in force allows this kind of interventions. Furthermore we have space to do that since the region countries and most of EU countries despite differentiation of VAT also they have higher rates.

The third we expect to have more revenues from VAT because of raising consumption for those commodities, which will lead to grow the income from those revenues.

Fourth benefit is that the consumption for the commodities/ and services whose VAT will increase to 17% will not be expected to decrease, while the purchasing power for other commodities that will have VAT of 7% will be increased, which means that the purchasing power will be balanced among them.

Applying reduced rate on VAT somehow poor spend greater proportion on food but wealthy people spend much more on food and benefit and as a result benefit more.

6.2 Disadvantages of VAT increase

There would be reaction by the media that the prices will increase in general, which will affect the population mood toward this scenario. Businesses, besides that will increase the price because of VAT increasing, they will also use it as an opportunity to increase their base prices with the reason that the VAT will affect also those prices.

Kosovo Tax Administration (KTA) will have to bear the administrative cost of changing the VAT, by changing their forms, more training for the staff and additional inspection.

The other expectation is also from lowering the VAT threshold we will have 8 million ²⁹euro revenues based on calculation of other positive side of lowering VAT threshold is raising the tax base for collecting this tax and fighting business informality.

²⁹ CAFAO Cost benefit analysis

According to CAFAO analysis, it is not known how many potential VAT filers there are and shows that some companies do not file even though they pass the existing threshold. They suggest that “an information campaign may increase the number of VAT filers not only in the range between 30-50 000 euro but also above 50 000 euro.”³⁰ The effect of this campaign will be large. If the threshold is decreased there would be costs and potential benefits for filing VAT, however the exact gains and losses is very difficult to be measured.³¹ In general, a lower threshold will be an incentive for companies to file their VAT, which bring more revenue. With other words it will be increased the tax base for bringing to the budget more revenues from

6.3 Excise

Excise taxes are defined as revenues from the goods that are for sale and consumption on the specific products as tobacco, alcohol beverages, cars and other luxury goods.

For the purpose of calculating the excise tax, the taxable value of goods would consist of their total customs value, estimated in accordance with international practice, plus customs duties, if applicable, or their value calculated by the retail price.

The superiority of this tax is considered as a fiscal instrument in the government hands, the main purpose of the application of this tax is to discourage consumption of some specific products and to ensure equality of consumption taxes and push customers to the products select supply or use them (i.e.: smoking, environmental conservation, etc..) then the government can increase the excise rate to generate more revenues, or to reduce them and this is considered as a support role. Taking in to consideration revenues on import of tobacco product and of course this product which is considered as luxury goods same as alcohol in this case there are three scenarios low, medium and high on increasing excise duties.

In the tables on increasing excise on tobacco the assumptions are based on fluctuation of demand on tobacco and this fluctuation is around -0.3

³⁰ CAFAO Cost benefit analysis

³¹ CAFAO Cost benefit analysis

Considering this fluctuation it means that the demand for this commodity does not change much, and in this case we can consider that the increase of excise on tobacco is more or less guaranteed revenue.

Those scenarios for increasing excise tax on tobacco are different; there is also an extreme increasing which means an increase from 21 euro per unit to 50 euro per unit. In this case the revenues from this tax will bring 57.00 mil Euros more than existing revenues from this tax. Nevertheless we have to be careful if we take this step because excise tax on tobacco in region countries is lower, so in the near future we will expect fiscal evasion and decrease of revenues. The best scenario is considered the low scenario which goes increase on 25 euro per unit and this increase will bring more revenues from this tax 11.75 mil euro.

This increase is more appropriate because the value of excise it will be somewhere in between in comparison with the region countries and in this case we will try to avoid fiscal evasion.

Increasing excise tax on tobacco it has so many advantages and the main advantage is effect of reducing cigarette consumption and this will result on health of population.

There has been a lot of research done to better understand the effects of taxation on cigarette consumption for example Serginio Sylvain Massachusetts Institute of Technology in the article “The Effects of Excise Tax on Cigarette Consumption Divergence in the Behavior of Youth and Adults”. In this paper the author aims to investigate the effects of increasing the excise tax for adults and youth.

It mentioned than since cigarettes are addictive, it could be expected that taxation would have little or no effect on the number of cigarette smoked per day or the percentage of smokers within a given population.

Advantages on increasing the excise tax are that the people would quit smoking and this helps people to be healthier, and on other side it would decrease the costs of diseases that are caused from smoking.

6.4 Increase of excise duty for alcohol beverages

Other possibility for more revenues is increasing excise duty for alcohol beverages.

An increase from 300 to 400 Euros per hectolitre would increase the revenues for around 1.26 million Euros under assumption that this change will not exacerbate the fiscal evasion. As favourable the increase of excise duty from 300 to 400 Euros per HPA may be, there is still room for an increase to 600 Euros per HPA. However, there are sound reasons to limit the increase to 550 Euros as this would be the highest excise in the region leading to a lucrative alcohol smuggling activity and fiscal evasion. On the other hand, unchanged excise duty of 300 Euros per HPA may not fully avail of the potential to enhance the revenues.

Although several countries of the region have exempted the wine from payment of excise duties in view of its status as the table beverage (drunk during meals), this exemption may not be equally justified in Kosovo, as the wine does not enjoy the same status in most Kosovar families. This may only apply to certain international individuals, who have a better buying power, which in itself does not constitute a viable reason for exemption, while excise duties are applied to beer and other alcoholic beverages in line with the percent of alcohol they contain.

Therefore, a raise of excise duties for alcoholic beverages will not only enhance revenues but also protect the health of our citizens. This policy will not only raise revenues but also decrease additional health care costs for the government.

There might be justifiable concern that the increase of the excise tax will increase the costs of local alcohol production, but this effect is limited for several reasons. First, the level of alcohol production in Kosovo is not inhibited by the price of alcohol, but its main obstacles are the small markets due to border restrictions because of violation of CEFTA agreement. Also Kosovo has not yet established the necessary trade routes for export of alcohol. Moreover most of the alcohol in Kosovo is imported from foreign countries which mean that the increased excise will mostly be collected from imported alcoholic drinks. In addition the alcoholic drinks which are mostly produced in Kosovo are wine and beer and those two drinks are the ones among the drinks which contain the smallest percentage of pure alcohol, and this means that they will pay a smaller excise tax per litre, because the excise tax is calculated from the amount of pure alcohol only.

6.5 Excise tax on vehicles

The Scenario two is more appropriate because of the assumption that the allowed vehicle age is 8 to 10 years would bring 3000 vehicles more per year and with moderate raise in excise duty this scenario would generate 9,9 million Euros more.

While the amount of new imported vehicles is 1013 and second hand imported vehicles is 14125, which means that the import of second-hand vehicles is more than ten times higher than new vehicles. This indicates that the import of second-hand vehicles is dominant and therefore in view of the clear preference for second-hand vehicles and the goal of increased revenues, the following provides an overview of scenarios for extending the age of imported vehicles and raise the excise based on age and engine cubic volume. This scenario discourages import of second hand vehicles and this is positive for environment.

Consequently, an increase of the average age of vehicles in Kosovo is expected. It is also reasonable to suppose from the daily practice that the distribution of vehicle age frequency follows the Poisson distribution. This means that there are few new vehicles in Kosovo but the higher the age the more vehicles there are in Kosovo until certain limit, when the number starts dropping again.

6.6 Tax on transfer of real estate and vehicles

After considering a broad range of new taxes, it is proposed that taxes on transfer of real estate and vehicles is introduced, because of its potential for generating revenues, without adversely affecting the application of existing taxes.

In order to achieve a more balanced distribution of tax load on various vehicle owners depending on the impact on environment and traffic in Kosovo, several similar scenarios are presented along with revenue forecasts for each of these scenarios.

There are also three scenarios for introducing this new tax and it's considered the most appropriate to take for both transfer on real estate and transfer on vehicles 3 % .Considering the current economic and social condition in Kosovo this tax burden are symbolic for the citizens. This tax is applied in the most of region countries and EU countries where despite the tax on transactions there are and subject of VAT legislation.

Taking into consideration this kind of tax policy in those countries, this is steep forward on following their tax policy, and applying them in Kosovo.

Introducing 3% tax on transfer of real estate we will have revenues about 13.24 million€and also introducing 3%tax for transaction of vehicles the revenues from this tax would be 2.51 million€ so it means that in total we would have 15.75 million€revenues from this tax.

6.7 Aggregated scenarios

This project includes three possible scenarios with high, medium and low budget revenues. In addition to above explained scenarios it is included this alternative scenario for ways of collecting revenues .The calculations are made using matrix based on results from calculation made using different rates in each scenario.

Table 6.1 The total of high medium and low scenarios

	High scenario	Medium scenario	Low scenario
VAT	142.99	83.98	54.76
Excise	164.41	132.01	97.10
Tax on transfer of real estate and vehicles	26.25	15.75	10.50
Total	333.66	231.74	162.36

First, in the high scenario it was applied the standard VAT rate of 20 % and differentiated VAT rate for certain products of 10 %. Also, the excise rate in this scenario is 50 euro for kg and the new introduced tax on transfer of real estate and vehicles is 5 percent. So taking this into consideration the total revenues from these three taxes are 333.66 million Euros.

Second, in the medium scenario the standard VAT applied is 18% and the reduced VAT rate is 9%. As well, the excise tax rate is 35 euro for kg and for new introduced tax on transfer of real estate and vehicles 3%. Thus, the total revenues in the medium scenario are 231.74 million Euros.

Third, in the low scenario the standard VAT rate is 17% and reduced Vat rate is 7%. At the same time the excise tax rate is 25 euro per kg and the new introduced tax on transfer of real estate and vehicles is 2%. As a result the total revenues in the low scenario would be 162.36 million Euros.

Table 6.2 Scenario analysis – Matrix if the VAT is high

Total revenues	High	Medium	Low
High	333.66	274.65	245.43
Medium	290.75	231.74	202.52
Low	250.59	191.58	162.36

In the table above it is presented the matrix of the combination of the three different taxes in the high, medium and low scenarios. There are nine possibilities of combinations. However, in this instance it is explained only the scenario where the VAT resumes high and the other taxes vary, as shown in the first column.

The first possibility is when the VAT, excise tax and tax on transfer of real estate and vehicles are all high and that would generate high incomes of 333.66 million Euros.

The second possibility is when VAT rate stays high and both excise tax and tax on transfer of real estate and vehicles are medium then the revenues from this combination would be 290.75 million Euros which means 42.91 million Euros less than the incomes from the high scenario. Furthermore, in the third case when the VAT rate is again high and excise tax rate and tax on transfer of real estate and vehicles are low then the revenues would reach 250.59 million Euros and we would have less revenues for 85.06 million Euros compared to the high scenario and 40.15 million Euros compared to the medium scenario.

Table 6.3 Scenario analysis – Matrix if the Excise tax is high

Total revenues	High	Medium	Low
High	333.66	231.74	266.34
Medium	264.15	231.74	196.83
Low	229.68	197.27	162.36

In the above table it is presented the matrix of combination when the taxes are combined from different scenarios. As in the first matrix, where the focus was given to the high VAT scenario, in this matrix the focus will be given to the possibility of high excise tax. Therefore in the first column are shown three possibilities when the excise tax is high and the other taxes are variable.

The first option is when excise tax, VAT, and tax on transfer of real estate and vehicles are all high, and the revenues would be the same as in case when the VAT rate, excise tax and transfer of real estate and vehicles was high the incomes would be 333.66 million Euro.

The second possibilities when excise tax remains high and other taxes as VAT rate and transfer of real estate and vehicles are medium the revenues from this option are 264.15 million Euro which means 69.51 million Euro less than in the first case when all taxes remains high.

The third option is when the excise tax is also high and other taxes as VAT rate and transfer of real estate and vehicles are low the revenues from this combination would be 229.68, which means that 103.98 less revenues comparing with high scenario when all taxes are high and 34.47 million Euros less, comparing with second option when the excise tax is high and other taxes are medium.

Although these scenarios would enhance budget revenues, the suggestion is to refrain their use as a short term policy for enhancing revenues. As most world economists agree, fiscal policies may be used to exercise long-term influences in economy. Therefore, we suggest enhanced performance of TAK in order to fight the fiscal evasion, and expansion of customs control in all territory of Kosovo especially north of Mitrovica. The propose is to proceed with most of proposals under those scenarios, but only because those scenarios brings us closer to European legislation and improves the life in Kosovo rather than temporary budget increase.

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