Tax Incentives in Kosovo Tax System

Bedri Peci[1]

Abstract: The aim of this research is to analyze and find out the major issue of tax incentives in Kosovo tax law. In this analysis we have used the research method of case study. The results of research show that Balkan countries in their tax systems have applied various mitigating measures that in tax theory are known as tax incentives. Taking into account that Kosovo regarding the application of tax incentives of CIT, compared with other countries is the last, designers by using the experiences of other countries should apply more tax incentives in order that tax policy to be more in function economic development. The study is of particular relevance to scholars, tax practitioners, expatriates who work and invest in Kosovo, etc.

Keywords: tax incentives; CIT; tax rates; foreign investment

JEL Classification: H25; H50

1. Introduction

The Balkan countries are competing with each other in attracting foreign direct investment (FDI) because of the positive effects that host (receiving) countries have expected. The Balkan countries (Kosovo, Albania, Bosnia and Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia) have gone through a process of transition, accompanied by liberalization and privatization, where foreign capital has played a very important role. Not all Balkan countries have been equally successful in attracting foreign capital, and their position depends on the specific location and institutional characteristics of each country (Škabić, 2015, p. 1). In function of accomplishing such intensions, Balkan countries in their tax systems have applied various mitigating measures that in tax theory are known as tax incentives. (Zee & Stotsky & Ley, 2002, Easson, 2004, UNCTAD, 2000, Simović & Zaja, 2010).

Taxing incentives are included in various reforms which are presented as tax relief, tax holidays, and reduction of tax base, or relief from tax obligation. Tax incentives are instruments with which countries are served aiming in favoring specific

[1] Associate Professor, Dr.sc. Department of Financial Law, Faculty of Law, University of “Hasan Pristina”, Kosovo, Address: Agim Ramadani Str. p.n., 10000, Pristina, Kosovo, Corresponding author: bedri.peci@uni-pr.edu.

categories of tax payers (specific sector, enterprise or individual) and in function of simulating specific economic activities.

Through tax incentives, the state intentionally accords for reduction of public incomes which will have in disposition. This for the fact that state achieves the same effect if it would gather this portion of taxes, and which later through budgeting costs in indirect manner it would share through subventions for sectors and specific activities. The incentives' application causes decrease of budgeting incomes and this phenomenon in tax theory is called tax expenditure. In tax theory, doesn't exist single and accepted definition related with tax expenditures. In this context, most proper definition would be that tax expenditures include all the measures which are undertaken in the existing tax form with which loss of budgeting income are caused due to decreasing of taxing base or tax obligation. In this case a portion of incomes aren't calculated at all, as it flows from specific tax form. This part of incomes that is not calculated and isn't gathered from this specific taxing represents that which is called tax expenditure.

While according to the classic tax theory, tax incentives doesn't have any important role in simulating investments and in economic developing, contemporary tax theory, tax incentives are seen as very important and influential in this direction. More specifically, in old tax theory exists conclusion that role of tax incentives in relation with foreign investments is secondary compare with basic determinants, as it is the size of a state, approach in unwrought materials and availability of a qualified working force. Investors in general attempt to adapt two-steps process in the case of evaluation of one state, as a country for investments. In the first phase, they analyze country based in its basic determinants. Just those states which have been through these criteria are taken into consideration in the future phase of evaluation, where tax norms, grants and other incentives can be important. Therefore, tax incentives in relation with foreign investments have only the secondary importance. Different from classical theory, contemporary theory sees tax incentives as a very important factor and decisive in this direction. (UNCTAD, 1996, OECD, 1998, Shah, 1995, Alm & Martinez-Vazquez & Rieder, 2016, Mutti, 2003, Peci, 2011) As a base of such stance is the fact that in globalization area the whole countries have undertaken the same measures as states with full investments, as well as also for economical-regional intentions they have undertaken same measures with those of European Union, where the process of tax harmonization and mutual economical politics are more intensive than ever. Another issue that is needed to be states is lacking of proper analysis and reports for tax expenditures that Balkan countries have in the moment of application of tax incentives. While analysis and reporting of tax incentives in developed countries is done regularly in budget process, this doesn't happen in developing countries. And even if this is done by Balkan countries these analysis and reports are not adequate and are not described in details.

Therefore, the aim of this analysis is highlighting some of basic specifics which characterize policy and tax system in Kosovo, after proclamation of its independence in the case of its reformation. For this purpose we have made these questions: which is tax structure of Kosovo Tax System and which are tax incentive measures which are applied in tax system of Kosovo?

In this analysis we have used the research method of case study, based on theoretical and empirical data. Furthermore, the methodology of the research is based on analyzing taxing laws based on which the system and fiscal politics are developed, as well as reports of Ministry of Finances. For comprehensive purposes the analysis of case in Kosovo was made based on different papers which talked about transition countries, as well as other secondary sources.

Except introduction paper is laid out as follows. Part II presents an analysis of tax structure of Kosovo tax system. Part III analyzes the tax incentives through reducing tax rates. Part IV belongs to overview of tax incentives related to Corporate Income Tax**.** At the end conclusions are given.

2. Tax Structure of Kosovo Tax System

The countries in transition have applied different tax forms as far as the selection of their tax structure is concerned. Countries with higher per capita income and with a more developed tax administration have a tax structure resembling more to the European Union countries. This was a result of the efforts of these countries to become the EU members through the harmonization of their tax systems, whereas countries with lower income (revenues) and with a poorer tax administration have built their tax structure on the basis of indirect taxes (Peci, 2009, p.46). For the purpose of analyzing the development of Kosovo tax structure after independence, we have analyzed it for the years 2012 and 2014.

Table 1. Structure of Kosovo Tax System for the Years 2014 and 2012

Tax forms and other source of income	Incomes 2014	Structure 2014	Incomes 2012	Structure 2012
Border Taxes:-Customs, VAT and Excise	870.978	60.11%	844.861	55%
Returns from Customs	2.408	6.01%	2.074	0%
Internal taxes:-Personal Income Tax, Corporate income Tax, VAT	303.695	20.95%	283.915	18%
Returns from TAK	31.108	0.46%	32.763	2%
Non-tax revenues central level	47.386	0.30%	41.145	3%
Municipal Own Source income	60.955	0.23%	59.448	4%
Central Own Source Income	36.49	2.51%	44.835	3%

Concession fee	5.293	2.73%		
Royalties	26.539	0.54%		
Dividend	15	9.65%	45000	3%
Privatization proceeds			23.934	2%
PAK dedicated revenue	2.3	6.29%	16.245	1%
One-off financing of PAK				
Repayment of loans by POEs				
Receipts from emission of securities	104.007	0.13%	73.313	5%
Borrowing from IFIs	9.829	1.47%	93.677	6%
Budget support grants			37.417	2%
Total incomes	1.448.957	100%	1.537.955	100%

Source: Annual Financial Report 2014, Ministry of Finance, 2015

From the analysis of the structure of general public incomes of Kosovo, it appears that as before also and after the proclamation of the independence, indirect taxes have dominated as well as custom and VAT. In the year 2012 and 2014 we had the same report of participation for direct and indirect taxes such as also in previous years.

3. Tax Incentives through Reducing Tax Rates

The Balkan countries, similar to the European countries and other countries of South-Eastern Europe constantly reformed their tax systems by reducing the rates (Peci, 2013, p. 6). This was done mainly aimed at attracting foreign investors, respectively to create a competitive taxing system in Balkan region. The comparison of Corporate Income Tax (CIT) norms of Serbia, Montenegro, Macedonia, Albania, Kosovo and Bosnia & Herzegovina, with average norms of EU CIT, we might say that Balkan countries have lower norms and that low norms of CIT can be qualified as tax incentive.

Regarding Kosovo case, creators of tax policy in January of the year 2009 did a reduction of tax norms in two main forms of direct taxing, CIT from 20% to 10% and Personal Income Tax from 0%, 5%, 10% and 20% to 0%, 4%, 8% and 10%. At CIT, creator’s aim was that through reduction of tax norm, to increase the competition capacity of Kosovo vis-à-vis foreign direct investments, respectively CIT norm to be harmonized in the level of existing norms of CIT that were already existing in Balkan countries.

At the case of PIT creator’s aim was to achieve another objective; that of fighting fiscal evasion, respectively attracting tax subjects so that by stimulating with tax burden they move from subjects of gray economy to subjects that manage to carry out their tax obligations. In difference from two ahead mentioned forms, at the increase of VAT norm from 15% to 16% designers had fiscal intentions, respectively the aim was to be done the compensation of public incomes that would be lacking along with decreasing of tax norms of CIT and PIT.

On 1 September 2015, the amendments to the Law No. 05/L-037 on Value Added Tax entered into force. Changes to VAT are consisting to rate. The standard rate is 18% (previously, 16%) and for first time is applied reduced rate of 8% which applies to the supply of: water, utilities, specific food products and medical equipment. This represents a 50% decrease from the initial standard rate of 16%. Considering the importance of VAT on budget revenues, in order to make up for the lost revenues with the introduction of the reduced rate, the Draft Law on VAT foresees an increase of the standard rate from 16 to 18% for all other remaining categories. In the meantime the rate of 0% is applied to exports with the aim of stimulating export-oriented companies. At VAT, creator's aim was that through reduced rate of 8% tax policy to be more in realizing social equality. VAT is one of the most efficient tools of the government for revenue collection given that it constitutes for more than 45% of tax revenues (TAK, 2004). Except decreasing of tax norms, Kosovo have applied few numbers of tax incentives to CIT in order to simulate foreign investors which we will treat in following.

4. Tax Incentives Related to Corporate Income Tax

As in other Balkan countries, in Kosovo since the beginning of the process of tax reforms an important number of tax incentives are applied and are still applied with added intensity. In this context, tax incentives mainly are related to CIT.

Relevant literature about tax incentives to CIT, have grouped the tax incentives in few groups such as: reduced norms of CIT, taxes decreasing, incentives for investments in a wide concept, which covers tax incentives as an accelerated amortization, tax credits in disposition for investments, decrease for qualified expenditures, decrease or zero norm, amortization based on employment, etc.

The role of tax incentives of CIT at the foreign direct investments promotion has been the object of various studies, but their disadvantages and advantages never have been clearly defined. In practice, spectacular successes have happened as well as important deviations in the application moment of tax incentives of CIT in attracting foreign investments.

In the context of this analysis for comparison of Kosovo case the main emphasizing will be done just upon tax incentives to CIT. A great number of tax incentives are applied inside of this tax form in contemporary tax systems of the world, excluding Kosovo that still applies them in very poorly (Table no. 2).

Table 2. Types of tax incentives applied in the world and Kosovo case

Tax incentives	Developing countries (52)	Developed countries (51)	Total (103)	Kosovo
Reduced CIT rates	43	40	83	Doesn't apply
Tax holidays	37	30	67	Doesn't apply
Accelerated depreciation	26	21	47	Doesn't apply
Investment allowance	18	8	26	Is applied to CIT
Social security reductions	5	7	12	Is applied to CIT
Import duty exemptions	39	24	63	Are applied
Other	32	13	45	2

Source: Easson (2004) cited by (Simovic & Zaja, 2010) "Tax Incentives in Western Balkan Countries", World Academy of Science, Engineering and Technology (2070-376x)4,6; 111-116, Kosovo case is prepared by author according to Kosovo Tax Law.

The majority of more than hundred existing types of tax incentives presented above are actually CIT incentives. In the case of Kosovo tax incentives are presented by referring exclusively to CIT. From the table can be seen that Kosovo in comparison to the compared countries, it very little applies tax incentives, by making that policy and tax system in this segment not being in function of economic development.

From the study done by the American Chamber of Trade through surveying companies which have invested in Western Balkan and Southeast Europe it shows up that one of the main causes of hesitations to invest in Kosovo are the non-existence of enough tax incentives, respectively disadvantaged tax environment (Zeka & Hapciu & Cakuli, 2010, pp. 1-20).

5. Conclusions

Tax incentives are instruments with which countries are served aiming in favoring specific categories of tax payers (specific sector, enterprise or individual) and in function of simulating specific economic activities. Regarding Kosovo case, creators of tax policy did a reduction of tax norms in main tax forms with aim to increase the competition capacity of Kosovo vis-à-vis foreign direct investments, respectively CIT norm to be harmonized in the level of existing norms of CIT that were already exist in Balkan countries. However, Kosovo compared with other countries is the last, regarding the application of tax incentives of CIT.

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