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Analysis of Tax Culture in Kosovo

Abstract

This paper focuses on conducting an initial investigation of tax culture in transitioning countries, using Kosovo as a case study. Is tax reform usually successful in achieving success? Complex legal definitions, extensive administrative procedures, and a lack of a culture of voluntary compliance may encourage individuals to engage in informal economic activities rather than function within the official economy on the path towards a market economy. This study elucidates several aspects of tax culture in nations undergoing economic transitions.

Keywords: Tax, investigation, economic, transitions, kosovo

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Introduction

Over the last 15 years, there has been a significant shift from centrally planned countries to free market-based economies, marking a major experiment in the world economy. Kosovo's economic reform has been implemented in nearly all sectors of the economy, achieving different levels of success.

Kosovo has achieved economic growth since 2001, with an increase in GDP and a decrease in inflation, despite the economic challenges caused by regional conflicts and instability. The Kosovar government has consistently restricted finances for public expenditure. The Kosovar economy is still experiencing substantial budget deficits as a result of the inadequate collection of tax revenues. In 2013, the state budget had revenues of 1.5 billion and expenses of 8 million.

In 2012, total central and local budget receipts amounted to about ___ million euros, equivalent to 16 percent of the Gross Domestic Product (GDP). Tax receipts in Eastern European countries account for approximately 35% of GDP, but in former Soviet Union countries, they are around 27%. In wealthy countries, these percentages range from 38 to 45 percent.

The tax-to-GDP ratio is commonly utilized to assess fiscal management; however, it may not provide a complete representation of possible tax collections. IMF assessments indicate that the tax reform in Kosovo during the past few years has shown positive progress. Nevertheless, the informal economy's level is exceedingly high. Progress in tax reform does not equate to full success in implementing fiscal policy. Another index is required to comprehensively summarize and represent all facets of fiscal policy.

This opinion suggests that "tax culture" can serve as an indicator for this purpose. Economists interpret this phrase differently, with some focusing on the tax legislation implementers and others on the taxpayers.

While many economists stress the significance of tax culture, they do not offer specific definitions of this concept. Birger Nere defines tax culture as the official and informal institutions associated with a country's tax system and its practical implementation, which are deeply rooted in the country's culture and influenced by ongoing interactions.

The extent of formal rules and their enforcement in informal tax practices determine the tax culture of a nation.

Formal rules established by the legislature in many transition countries lead to uncertainty and impose high compliance costs on tax inspectors and taxpayers. Consequently, the relevant actors avoid and do not adhere to formal rules, leading to the establishment of informal governance institutions. Formal norms are substituted with informal rules, and new informal institutions are established. The way Kosovar businesses handle tax avoidance and evasion is one example of how formal norms are giving way to informal "laws."

Between 1990 and 2000, state ownership and covert taxation tactics were prevalent, leading many individuals to believe they were not paying taxes. This is one reason why taxpayers in Kosovo lack the tax-paying conscience commonly found in affluent countries. Questionnaire 92% of people believe that the tax system is unjust. The latter group is more confident that the taxes they pay will be allocated towards social and public services such as healthcare, retirement, and education. Several tax reforms have been implemented in our country during the past 15 years, focusing mostly on tax legislation. Other aspects of the tax culture have remained much the same. Indeed, taxpayers' outrage and opposition have intensified. Changing fiscal legislation without addressing the fiscal culture and other variables influencing the tax culture would not result in major fiscal impacts. Tax reforms often fail to generate the intended revenue promptly due to several factors. In contrast, these techniques yield the desired outcomes more rapidly in wealthy nations.

Figure 1 illustrates the tax culture model, including its primary components and the factors that impact it. The tax culture of a country is influenced by its historical, geographical, political, and social characteristics, as depicted in the diagram. The components of the national tax culture include tax legislation, tax management, and adherence to tax regulations. Kosovo stands out among countries that have undergone this transformation due to its unique lack of "entrepreneurial memory," unlike most Eastern European countries. During the transition to a market economy, various issues, particularly corruption, have arisen in varied manifestations. In Kosovo, the majority of bribes are paid to the customs and tax authorities, indicating that corruption is most prevalent in the taxation sector.

Political and geographic considerations significantly influence a country's tax culture. (There is a need for substantial additions regarding Kosovo.)

Kosovo, Serbia, Macedonia, Albania, and Montenegro serve as viable transit routes for importing various goods. These issues make it difficult to regulate the movement of products and impact the tax collection process.

Societal influences in tax culture are evident in the presence of societal norms on the readiness to pay taxes. In underdeveloped countries, individuals are more motivated to evade taxes than to willingly pay them, unlike in rich countries. These variations are contingent on the social tax rate element. Individuals who view paying taxes as a social norm are more likely to pay taxes consistently. Social tax rates in a country depend on public opinion. If non-payment becomes prevalent, social norms on willingness to pay taxes diminish. It requires the words to be paraphrased. Tax compliance and social norms varied significantly across countries. In numerous countries, particularly those undergoing change, tax evasion is not typically viewed as an economic offense.

Between 1990 and 2000, communist ideology and laws significantly restricted private enterprise, making it more challenging for people to improve their financial situation through this route as opposed to engaging in corruption or other criminal activity. Generally, everybody received equal compensation regardless of their varying capacities. Public officials associated with the party were in safer conditions and more susceptible to corruption than other members of society. When teachers and doctors accepted money from "illegal private activities," communist ideology viewed this behavior as more evil than power corruption. This established norm has led to a prevailing belief in Kosovo that working in the tax authority is considered more prestigious than working as a doctor or lecturer.

Tax evasion is commonly recognized as a key component of the informal sector. The marginal tax rate has an impact on fiscal evasion. Higher marginal tax rates typically lead to increased substitution effects and a greater inclination towards tax cheating.

Tax evasion can become prevalent and seen as socially acceptable and legal in a society where there is a general perception that the tax authorities do not actively pursue tax evaders and some tax inspectors even support tax evaders.

This conclusion is prevalent in numerous transitioning countries, where tax dodging is acknowledged as a societal norm. Vasquez categorizes social norms of tax compliance into two primary groups: the first relates to taxpayers' assessment of their action as suitable, permissible, and ethical. The second reason pertains to taxpayers' perception of bearing a just economic responsibility in terms of tax payments, public service benefits, and the accountability of governmental choices at both central and local levels.

Multiple sources show that countries with similar fiscal systems but different social standards have varying levels of tax compliance. An analysis of Kosovo's budgetary management reveals numerous unfavorable characteristics, similar to those found in former Soviet Union republics. Kosovo's fiscal legislation has undergone numerous revisions, particularly concerning VAT and excise charges. The primary aim of these practical modifications may have been to achieve tax fairness, increase tax revenue, and close legal loopholes. However, disobedience has been inadvertently sanctioned, perpetuating the significant disparity between revenue collected and tax revenue. Potential.

The government plans its revenues based on projected collection levels rather than making substantial efforts to align budget revenues with actual tax revenues. A review of revisions to fiscal law clearly demonstrates that lobbying from various sectors of the economy, particularly importing traders, impacts tax policy. This is evident in the reduced consumption of tobacco and oil.

Tax rates. Lobby groups in industrialized countries mostly advocate for the interests of key sectors in the economy when it comes to tax policy. In poor countries, unofficial lobbying serves to safeguard the interests of illicit firms. In 2002, cigarette imports for the duty-free shop totaled 500 tons, compared to 2400 tons for the entire region of Kosovo. This benefit facilitated smuggling through duty-free kiosks. Most of the cigarettes reported in this manner were imported and sold in Kosovo. Kosovo's tax system lacks transparency. Typically, firms are unaware if other businesses pay taxes under comparable circumstances. There are onerous restrictions in addition to the wide array of taxes and exemptions. Several regulations have been established to clarify income disclosure and determine tax obligations. Tax inspectors frequently apply these regulations in a biased manner toward certain taxpayers.

Continual alterations to the tax system adversely impact the expenses associated with tax compliance. Many businesspeople believe that paying all taxes without going bankrupt is impossible.

Tax administration in Kosovo often includes three types of tax audits:

Formal control.

This control is exerted over economic entities lacking unofficial protection, or "patronage," from unofficial power structures. These are subject to full taxation under current tax laws without major illegal arrangements or special rights. casual authority.
In this scenario, taxpayers bribe tax and customs inspectors to pay lower taxes to the state budget, which is a form of selective control.

In Kosovo, the tax administration's experience indicates that conducting comprehensive business audits is challenging and expensive because of the inadequate accounting system in place.

This enables authorities to conduct targeted control, concentrating on certain enterprises while disregarding others.

Unofficial government entities have a vested interest in controlling this. Political interest involves tax authorities showing preference for enterprises associated with the government or exerting strict control over businesses affiliated with the opposition.

Economic interest refers to the deliberate establishment of a hostile financial atmosphere for economic enterprises that are not favored by the informal ruling bodies, resulting in their economic decline. Selective control does not seek to eradicate unlawful behaviors. It benefits influential groups with economic interests backed by governing authorities.

Aside from the three methods of tax control mentioned, many companies with "patronage" from unofficial government entities evade fiscal oversight, giving them a clear competitive edge over regulated companies.

The transition era has led to multiple issues in tax administration. The degree of political and fiscal autonomy within the state has a significant impact on the latter, which is the main component of tax culture. Tax collection is more challenging with political decentralization but is facilitated by significant economic decentralization, as regional administrations have a greater incentive to ensure efficient tax collection. Fiscal decentralization decreases the motivation for local governments to support tax evasion by taxpayers. In Kosovo, the current tax revenue mobilization is low due to a tiny tax base and municipal taxes having a limited fiscal impact compared to national taxes. Big cities attract "very profitable" firms and workers due to the challenging economic conditions. Most local government units in Kosovo do not perform their budgetary role due to this being a primary factor. Economic agents who are subject to tax employ various techniques to adapt to the situation according to the established tax culture. Hirschman delineates three tactics employed by economic agents to address the uncertainty stemming from the new regulations:

knowingly evading or avoiding regulations, advocating for the universal application of formal rules and their enforcement, and ultimately, honesty and adherence to formal standards. Some entrepreneurs lack loyalty towards the official and regulatory authorities responsible for issuing and enforcing regulations. Most individuals opt for the avoidance option due to the lack of developed or independent institutional political and legal institutions to protect their interests.

The third component of tax culture is tax compliance, as previously stated. This aspect mostly manifests in the extent of fiscal evasion and avoidance among various states. Fiscal evasion manifests in various forms in Kosovo.

Tax evasion in personal income tax is linked to working in the "underground economy". Salaries in the private sector are often underreported, with employees actually being paid higher than the minimum wage.

In many developing nations, income tax has generated limited financial resources for the government because of low salaries and a tiny tax base with high marginal income tax rates.

The Income Tax forces businesses to report lower earnings by raising the cost of raw materials, creating phony invoices, and inflating payments for services rendered.

Indirect taxes make up approximately 65 percent of tax receipts in Kosovo. The value added tax is primarily supported by the import structure of the Kosovar economy, and the tax collection process facilitates fiscal avoidance.

Non-payment of VAT is prevalent in the trade and services sector, where the majority of transactions are conducted in cash. Commercial transactions are frequently unaccounted for in the financial records, thereby falling beyond the scope of the VAT payment system. Similar to other indirect taxes, evasion can occur through not reporting or underreporting the value of goods and services, or by using special reference prices for preferred enterprises.

One common kind of import evasion is customs smuggling, which involves using bogus transits or not declaring items at all. Approximately half of tobacco imports are estimated to be illicit. Additionally, the earnings generated from oil excise are much below their maximum level. In Kosovo, it is quite feasible to increase tax revenue by an additional 2 percent of GDP solely through lawful excise taxes on cigarettes and oil.

The facts above indicate that the tax income potential in Kosovo exceeds the current collection of revenues.

Tax evasion varies across countries based on the presence of certain inequities.

Let Bi represent the tax liability on the goods or service when R is more than 1 and Son when Rii equals 0. R1i represents the tax amount that has been unlawfully reduced for product or service i. Bi stands for the bribe received by a tax inspector for product i. The condition (1) applies when the taxpayer pays the reduced tax amount to the state budget and bribes the tax inspector. When the taxpayer pays no tax, (2) is true, indicating full tax evasion.

If Ri equals R1i plus Bi and B equals Ri, then tax evasion becomes impractical for the taxpayer, and tax compliance will prevail.

The extent of tax evasion is contingent upon the magnitude of these disparities.

Subtract R1i+B from Ri and subtract Ri from Bi

These distinctions reflect the level of development of each of the three components of tax culture in a country.

Executive and legislative bodies can alter these disparities within a state by modifying elements of the tax culture.

In Kosovo, the tax culture can be improved by enhancing the fiscal state's authority, reinforcing fiscal decentralization, and promoting social norms that prioritize the affordability of legal business operations over illegal activities. This approach aims to make tax evasion and corruption unprofitable and socially unacceptable, similar to other criminal behaviors. The Kosovo example demonstrates that the "tax culture" index indicates several facets of a country's fiscal administration and assesses the level of development of legal and executive entities as well as taxpayers.

Foreign investors base their investment decisions on criteria such as natural resources, political stability, transparent regulatory frameworks, and infrastructure. Investors can use the tax culture index to evaluate the fairness of business activity and the tax climate in a country. Kosovo is focusing on meeting the requirements of the Stabilization Association agreement, with tax collection enhancement being a critical issue for the government to address. Aligning the tax culture with European countries is crucial to achieve the major objective for the ambitions of the Kosovar people.

This metric is significant for creditor nations and international financial institutions. This indicator allows them to evaluate the capacity and readiness to gather taxes and, consequently, to repay debts. This paper aims to outline the tax culture model in Kosovo. Further research on the tax culture index, methodologies for its measurement, and the relationship between formal and informal rules warrants a more thorough investigation.

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