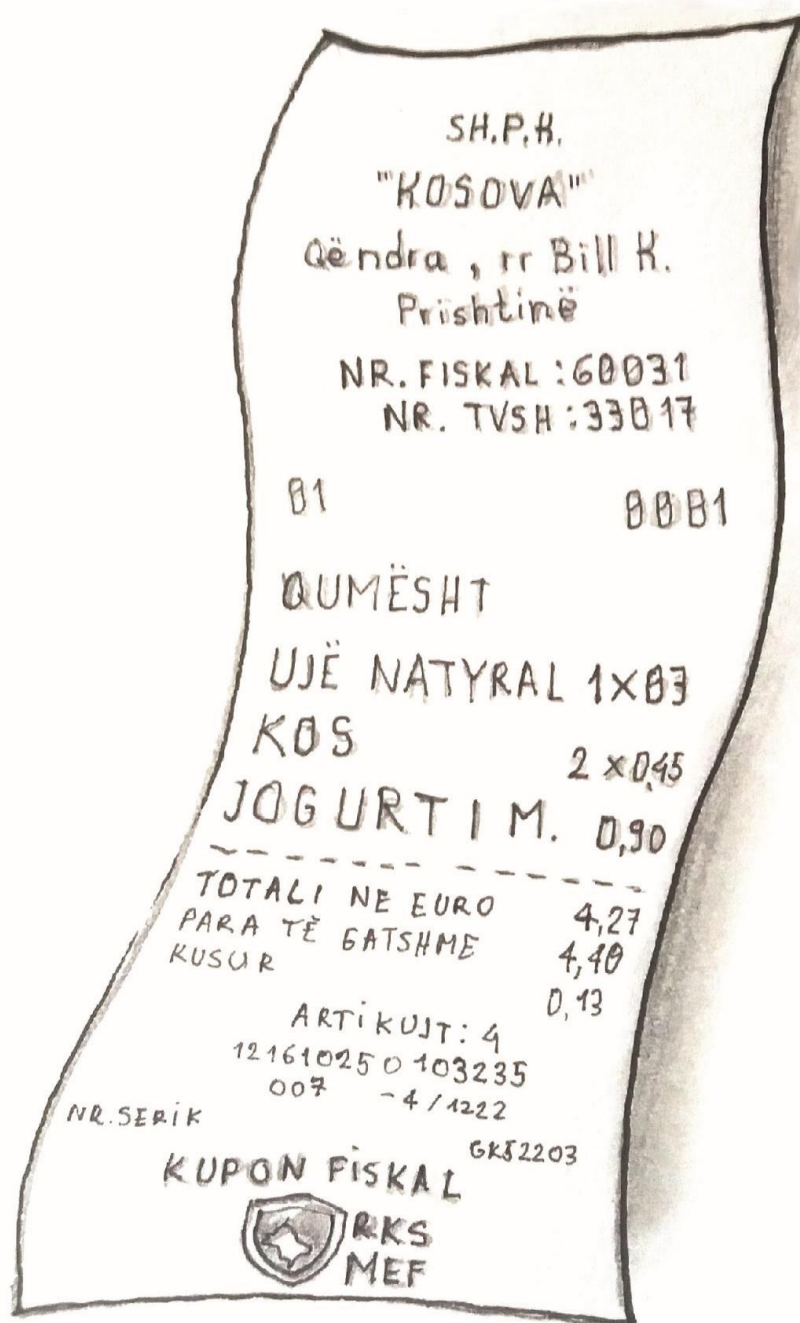


# Effects of the Law on Value Added Tax

November 2016



# 1. Introduction

Value added Tax (VAT) the main source of tax revenues in Kosovo. In 2015, VAT made up about 47% of the revenues from taxes.<sup>1</sup> In March 2015, the Government of Kosovo in the face of an expected increase of the budget deficit as a result of the raise in public sector salaries and expenses for the highway Prishtina - Skopje, was pushed to make a range of changes in taxes and excise taxes.<sup>2</sup> The decision which would potentially have the largest effect on the budgetary revenues, business activity and consumer prices was the adoption of the new Law on Value Added Tax. Through this law, among other things, the Government of Kosovo raised the VAT rate from 16% to 18% in majority of the products, while it lowered the VAT from 16% to 8%, mainly in food products.

In addition, the Government of Kosovo adopted a series of amendments related to fiscal policies, such as: The Draft Law on Corporate Income Tax, the Draft Law on Personal Income Tax, changing the level of excise tax on cars, cigarettes, alcohol beverages, oils, etc.<sup>3</sup>

Through this analysis, GAP Institute aims to measure the effects of the Law on VAT a year after its entry into force. The first part of the analysis provides a summary of the main amendments in the new Law on VAT<sup>4</sup>. The second part contains an analysis of the effects of reducing the VAT rate from 16% to 8% in customs revenues, domestic revenues and consumer prices. In order to measure the effect of the reduced VAT rate in customs revenues, from the database of the Kosovo Customs are isolated only those tariff codes in which pursuant to the administrative instruction, VAT is applied as reduced.<sup>5</sup> Within the second part are also analyzed the effects of application of VAT rate of 8% in medicines. The third part analyzes the effect in the budgetary revenues as a result of the increase in the standard rate of VAT from 16% to 18%. This section provides an analysis of the effects in customs revenues for the products on which the standard rate of VAT of 18% is applied. The same analysis could not be applied for the revenues of the Tax Administration of Kosovo (TAK), due to the lack of a database which provides information on income at the level of each product category. The fourth part analyzes some amendments in the Law on VAT which affected businesses, such as: removal of VAT on raw materials, machinery and information technology (IT), the reduction of the VAT registration threshold, reimbursement issues etc. In this analysis, in addition to the data from TAK, Customs, the Kosovo Agency of Statistics

<sup>1</sup> Ministry of Finance, Annual Financial Report, Budget of the Republic of Kosovo for the year ending on 31 December 2015, The Source: <http://bit.ly/28YehHp>

<sup>2</sup> International Monetary Fund, Kosovo: Concluding Statement of the 2015 Article IV Mission, 30 March 2015, Source: <http://bit.ly/1FccDJt>

<sup>3</sup> Government of the Republic of Kosovo, Decision no. 02/20, Decision 03/20 and 04/20, 24 March 2015, Source: <http://bit.ly/1bdrmMy>

<sup>4</sup> Official Gazette of the Republic of Kosovo. Law no. 05/L-037 on Value Added Tax. Published on 17 August 2015. Source: <http://bit.ly/2f0ErfI>

<sup>5</sup> Administrative Instruction No. 03/2015 on Implementation of Law no. 05/L-037 on Value Added Tax, Source: <http://bit.ly/2d2rPak>

(KAS), assessments were also taken from business representatives and professionals of the field of taxes.

## 2. Amendments to the Law on VAT

The new law on value added tax has entered into force on 1 September 2015. According to Finance Minister, Mr. Avdullah Hoti, this law was part of the fiscal package which aims to "foster employment, but also to increase the welfare of citizens, to improve the national trade balance of Kosovo and some other objectives."<sup>6</sup>

Some of the major amendments of this law include:

- Standard rate of VAT has increased from 16% as it was in the previous law to 18%. This amendment marks an increase in the level of VAT rate of 12.5% or two percentage points.
- The Government of Kosovo has applied a reduced VAT rate of 8% in some products and services. Some of these products and services include: public services (electricity, water supply, waste collection, heating system), cereal, flour, oil, milk, salt for human consumption, school textbooks, equipment of information technology, medicines, medical equipment, etc. Prior to the entry into force of the law, the VAT on medicines was 0%.
- The registration threshold and the method of calculating the business registration for VAT has changed. Prior to the entry into force, if a business has realized supplies less than €50,000 in a calendar year, then such business was not required to be VAT registered. With the new law, all those businesses which within a calendar year exceed 30,000 turnover are required to register for VAT.
- Upon approval by TAK, the production lines and machinery for use in the production process, raw material used for the production process, the information technology equipment shall be exempt from VAT.<sup>7</sup>

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<sup>6</sup> The Assembly of the Republic of Kosovo, transcript of the plenary session of the Assembly of the Republic of Kosovo held on 28 May 2015, Source: <http://bit.ly/1HJ4VfS>

<sup>7</sup> Official Gazette, Law no. 05/L-037 on Value Added Tax, Article 29: Source: <http://bit.ly/2e6Jl9w>

- Newspapers, periodicals, equipment and materials imported for the needs of the printed and electronic media are automatically exempted from VAT.

### 3. The Effects of the Reduced VAT Rate

As mentioned above, the new Law on the VAT for the first time has reduced the VAT rate in some products. While the law regulates only product categories in which reduced VAT of 8% can be applied, the tariff codes of products with reduced VAT are specified in an administrative instruction.<sup>8</sup> According to the law, Finance Minister can expand the list of products within these categories, without any approval by the Assembly of Kosovo.<sup>9</sup>

In order to measure the effect of reduced the VAT in customs revenues, we have analysed the database of Kosovo Customs related to customs' revenues at the level of tariff codes. Table 1 contains customs revenues collected in customs only for those tariff codes for which according to Administrative Instruction No. 03/2015 the reduced VAT of 8% is applied. As we see from Table 1, though from September 2015, VAT rate in these products has been lowered to 50% (from 16% to 8%), revenues collected from VAT have increased for about 1 million Euro (14%). The reason for this increase is the increase of imports in these products and the application of the rate of 8% of VAT on medicines. Prior to the entry into force of the new law on VAT, VAT on medicines was 0%.

**Table 1. Revenues collected in customs from products with 8% VAT**

	VAT		Customs duty		Total	
	Jan - Aug 2015	January-August 2016	Jan - Aug 2015	January-August 2016	Jan - Aug 2015	Jan - Aug 2016
Revenues without medicines	€7,442,080	€ 6,115,075	€ 1,676,912	€ 2,453,748	€ 9,118,992	€ 8,568,823
Medicines		€ 2,359,675	€ 2,143,542		€ 2,143,542	€ 2,359,675
<b>Total</b>	<b>€ 7,442,080</b>	<b>€ 8,474,750</b>	<b>€ 3,820,454</b>	<b>€ 2,453,748</b>	<b>€ 1,262,534</b>	<b>€ 10,928,498</b>

Source: Kosovo Customs

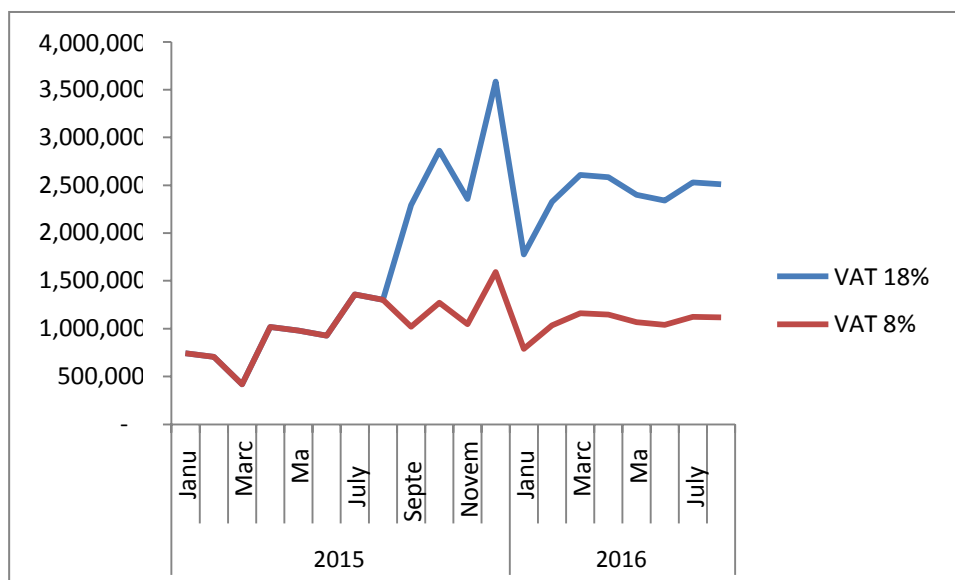
Taking into account the amount on which VAT of 8% is applied from customs revenues, figure 1 provides a scenario of how much would be the customs revenues in the period from January to August 2016, in the event that the in products with a reduced VAT would have been applied the standard rate of 18% VAT. Based on the calculations for the period January - August 2016, revenues collected by the customs in these products would be around € 19.1 million euro or about €10.6 million euro higher than current revenues.

<sup>8</sup> Administrative Instruction No. 03/2015 on Implementation of Law no. 05/L-037 on Value Added Tax: Source: <http://bit.ly/2d2rPak>

<sup>9</sup> Official Gazette, Law no. 05-037 on Value Added Tax, Article 26.3

In other words, while on average revenues collected from these products in the period from January to August 2016 were about € 1.1 million per month, with the 18% VAT would be € 2.4 million.

**Figure 1** Revenues from VAT collected at customs without VAT escalation



Source: Kosovo Customs

Reducing the VAT rate in some products has also had an impact on TAK revenues or domestic revenues. As seen in the table 2 in the period January - June 2015-2016 revenues of TAK have decreased for about € 11.6 million. In the event that this table would contain revenues collected from medicines, then the decrease of the tax revenues from VAT collection would be lower.

On the basis of an approximate calculation, if on these products and services standard VAT rate of 18% would be applied, it turns out that during the period January - June 2016 TAK would collect around € 7.5 million additional revenues (in total €13.5 million) compared to the current revenues.

**Table 2.** The impact of VAT reduction on TAK revenues

Activities	Payments January - June 2015 (€).	Payments January-June 2016 (€).	Difference of payments (€)
1	2	3	4=3-2
Production of electricity	8,828,229	€ 3,987,812	(4,840,417)
Trading of electrical energy	4,987,075	€ 1,062,883	(3,924,192)
Milk products processing	565,456	€ 194,323	(371,133)
Collection, treatment and water supply	834,954	214,062	(620,892)
Activities of the companies "holding"	270,373	158,196	(112,177)
Wholesale trade of products of milk, eggs, cooking oils and fats	219,450	153,545	(65,905)
Production of bread, croissants and fresh sweets	118,036	84,622	(33,414)

Maintenance and service activities and maintenance of squares (environment)	272,760	81,825	(190,935)
Production of brooms and brushes	327,004	21,841	(305,164)
Supply with steam and air conditioning	84	27	(57)
Road transport of passengers p.c.t.	28,468	7,279	(21,188)
Funeral services and activities related to them	74,528	3,082	(71,446)
Production of pasta, spaghetti and similar products of flour	€ 14,479	3,016	(11,462)
Production of computers and peripheral equipment	€ 6,692	2,740	(3,952)
Wholesale trade of computers, and peripheral equipment of computers and software	€ 1,712	6,102	4,390
Distribution of electrical energy	€ 1,014,984	-	(1,014,984)
<b>Total</b>	<b>€ 17,564,285</b>	<b>5,981,356</b>	<b>(11,582,929)</b>

Source: TAK

Regarding the impact of reduced VAT rate to the consumer prices, considering that Kosovo's economy operates on market principles, the state cannot directly affect consumer prices by reducing the VAT. Regarding the impact of the decrease of the VAT as an instrument of income redistribution, the findings show that reducing the VAT is not an effective tool to achieve this goal.<sup>10</sup> The impact of lower VAT on consumer prices can be noted if we compare the prices of the month of September with the previous month in some of the products on which the reduced VAT has been applied. The data on Table 3 suggest that there was no reduction of prices in all products with the reduced VAT. In addition, the lowering of prices on some products in September has not appeared stable until the end of the year. Taking into account the high level of import, consumer prices in Kosovo are more affected by the international market prices, rather than domestic economic or social factors.<sup>11</sup>

**Table 3. Consumer price index in products on which VAT has been reduced**


	September 2015 - August 2015	December 2015 - December 2014	Ø2015/Ø2014
Bread and cereals	-1.9	-0.2	0.6
Milk, cheese and eggs	2	-1.7	-2.9
Water supply and other services related to residence	-6.3	-5	-1
Electricity, gas and other fuels	-3.4	-2.5	3
Oils and fats	-0.3	6	2.3
Audio-visual and photographic equipment for processing information	-0.1	0	-1

Source: KAS.

<sup>10</sup> Group for Political and Legal Studies, An assessment of the VAT policy in Kosovo: its potential impact on consumers and businesses, Source: <http://bit.ly/2dpSjFh>

<sup>11</sup> Central Bank of Kosovo, the Financial Stability Report No. 09, July 2016, page 28, Source: <http://bit.ly/2dD46fR>





During our research on the application of reduced VAT rate, we have experienced an occasion when various economic operators have applied different VAT rates for the same product. The application of different rates of VAT for the same product is illegal, undermines competitiveness among businesses and lowers budget revenues.

In addition to food products, the list of products with reduced VAT also includes some of the IT equipment (such as: lap-tops, tablets, and computers). Reducing the VAT enables sellers and consumers of IT tools to sell, respectively buy IT products with more competitive prices compared with Macedonia considering that VAT in Macedonia on IT equipment is 5%.<sup>12</sup> Representatives of the Association for Information Technology have asked for expansion of the list of products with reduced VAT because a number of important products (e.g. printers) are not included in this list.<sup>13</sup> Compared to the same period, the import of IT equipment from chapter 8471 (which includes lap-tops, computers, tablets etc.) of the Integrated Tariff of Kosovo (TARIK),<sup>14</sup> has increased by 62% (from €5.6 million for the period January - August 2015 to €9,1 million for the period January - August 2016).

### 3.1 The VAT effect in the prices of medicines

As mentioned above, VAT of 8% in medicines began to be applied in September 2015, from zero what was before September 2015. At the end of that month, the Government of Kosovo took a decision that as part of goods exempt from customs duties, include the medicines within Chapter 30 of the TARIK.<sup>15</sup>

Customs revenues collected from medicines in the period from January to August 2016 from the application of VAT were around €2.4 million, or around €216 thousand (10%) higher compared to the same period of the previous year. If we take the monthly average, in the period January - August 2015, the Customs has collected around €268 thousand from customs duties, while during the period January - August 2016, were collected at an average of about €295 thousand VAT per month.

<sup>12</sup> ICT Sector in the Republic of Macedonia, <http://bit.ly/2e5sZNK>, page 23

<sup>13</sup> Association for Information Technology and Communication of Kosovo, Interview with Vjollca Çavolli - Executive Director, 10 October 2016

<sup>14</sup> Chapter 8471 contains automatic data processing machines and their units; magnetic or optic readers, machines for replication of data in or toward a coded data environment and such data processing machines, not specified or included elsewhere

<sup>15</sup> Administrative Instruction, QRK- NO.05/ 2015 on Custom Duty Exempt Goods,

Source: <http://bit.ly/2dLWFB4>

**Table 4. Customs revenues collected by Chapter 30 (medicines)**

January-August 2015	January-August 2016
€ 2,143,542	€ 2,359,675

Source: Kosovo Customs

The application of VAT rate of 8%, compared to the removal of import duty of 10% is expected to reduce revenues, but increase in revenues occurred because around 12% of medicines are imported from CEFTA countries, which were exempt from customs duties and due to a slight increase of import.<sup>16</sup>

The introduction of VAT and removal of import duty, potentially has raised the prices of medicines locally produced compared with imports of medicines outside the CEFTA countries. Based on KAS data, consumer prices for medical equipment and products in September 2015 increased by 2.4%, compared with the previous month or 3.2% compared to September the previous year. At the end of 2015, price index of these products increased for 1.7%.<sup>17</sup>

Although VAT could affect the increase of price of medicines produced in Kosovo, the largest manufacturer of medicines in the country supports the amendments to the Law on VAT. Two reasons why this law is seen as more favourable by domestic producer are: a) the company is provided with reimbursement of VAT on investment in building, machinery, etc.; b) the company has benefited from the VAT exemption in the raw material. Reimbursement has enabled the company to reduce the cost of initial investment, while VAT exemption of the raw materials has enabled to increase stocks for 16%. The latter has improved the liquidity and efficiency within the company, which also impacts in reducing the cost of production.<sup>18</sup>

## 4. The effects of the increased VAT rate

Upon entry into force of the new law on VAT, standard rate of VAT on most of the products has increased from 16% to 18%, or 12.5% higher than before September 2015. Based on the tariff codes of imported products in 2015, reduced VAT rate was applied in about 300 customs codes/products, while in about 5,500 other tariff codes, the VAT of 18% has been introduced. As expected, the increase of the VAT along with the increase of the import

<sup>16</sup> CEFTA has been created in order to eliminate the barriers to mutual trade between member states. More information about this agreement can be found on the website <http://cefta.int/>

<sup>17</sup> Kosovo Statistics Office, Consumer Prices Harmonized Index, September 2015, Source: <http://bit.ly/1bsMxTf>

<sup>18</sup> Trepharm, Interview with Mërgim Prishtina - Executive Director, 21 September 2016.



level has reflected positively on customs revenues. While in the period from January to August 2015 Kosovo Customs has collected around €250.7 million from the products on which standard VAT (18%) has been applied, in the same period of 2016 were collected €318.5 million or about €68 million (27%) more than in the same period of the previous year.

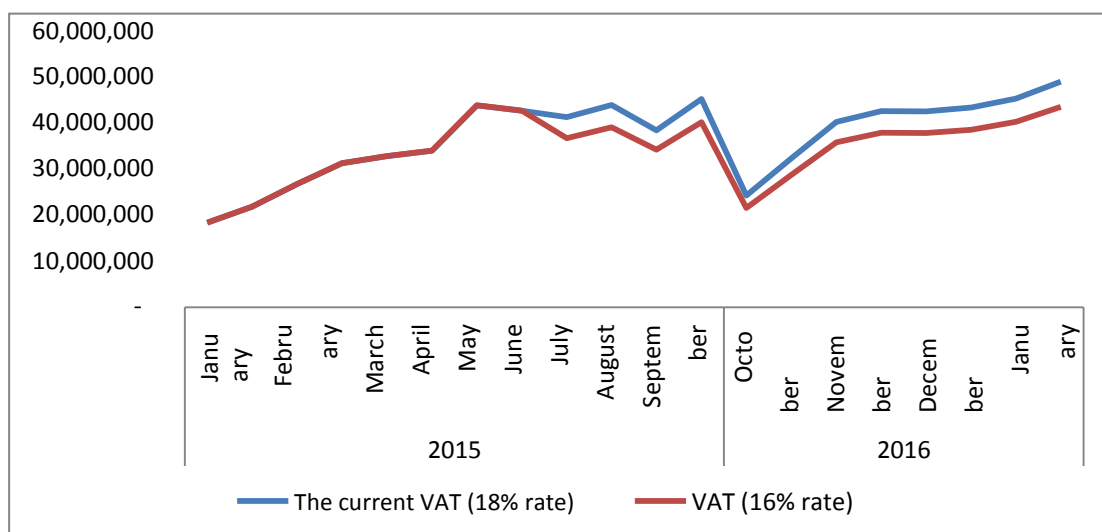
**Table 4. Revenues from standard rate VAT**

	Revenues from standard rate VAT
January-August 2015 (VAT = 16%)	€ 250,713,225
January-August 2016 (VAT = 18%)	€ 318,493,702

Source: Kosovo Customs

In order to measure the effect of the increased VAT from 16% to 18%, taking into account the money value of imported products on which standard VAT rate of 18% was applied during the period September - August 2015/2016, we have applied the VAT rate of 16%. On that basis, we see that customs revenues grew by an average of about €4.5 million per month as a result of increasing VAT rate. In the period from January to August 2016, compared to the previous year, the customs revenues only from VAT increase grew by about €35.4 million.

**Figure 2 Growth of customs revenues from the increase of VAT rate**



Source: Kosovo Customs and GAP Institute calculations

VAT increase has contributed positively also to the revenues of the TAK. In the period between September and December 2015, TAK collected around €6.5 million additional revenues from VAT from products/services whose VAT was increased.<sup>19</sup> If we take as a monthly average, then it turns that TAK revenues grew by an average of €1.6 million per month for this period.

<sup>19</sup> TAK, Response via e-mail, 27 September 2016

Table 5. TAK revenue

September-December 2014	Sept.-December 2015	Difference
1	2	3=2-1
€ 41,162,519	€ 47,684,620	€ 6,522,101

Source: TAK

## 5. Other amendments

**Exemptions from VAT.** As mentioned above, upon approval by TAK, the production lines and machinery for use in the production process, raw materials used for the production process and information technology (IT) equipment shall be exempt from VAT. Only domestic producers have the right to such VAT exemption in raw material, while only businesses that operate in the field of information technology or deal with IT resale are entitled to exemption in technology. For exemptions, businesses must apply to TAK.

The number of businesses that have applied for exemptions in raw materials from VAT in the period from December 2015 to September 2016 is in total 183, while the number of cases approved is 242.<sup>20</sup> The value of imports of raw materials exempted from customs duties in the period from January to August 2016 is about €62.3 million or €10.2 million charge of VAT. Regarding the information technology equipment, 11 businesses are exempt from VAT, while the value of exempted imports from VAT in customs is €1 million.<sup>21</sup>

Table 6. Exemptions from VAT from Kosovo Customs January - August 2016

Description	Import value (€)	Exempt. from VAT(€)
Production lines and machinery	26,266,520	4,669,547
Raw materials for production	62,455,649	10,191,187
Exemption of free circulation for production	1,543,009	305,394
Information technology equipment	1,028,784	86,102
<b>Total</b>	<b>91,293,962</b>	<b>15,252,230</b>

Source: Kosovo Customs

Exemption of these products from VAT is not a loss for the budget, because in the past this amount was reimbursed to businesses. But now, businesses do not need to wait for a refund of the VAT until they realize the sale of their products. This increases the liquidity of Kosovar businesses and also is likely to have effects on increasing the efficiency. This is because businesses are able to collect greater quantities of raw materials in stock. In the absence of detailed financial data for businesses that have benefited from exemptions from VAT, it is hard to measure the effects on the

<sup>20</sup> TAK, list of t/p that were approved for exemption of VAT on importation of goods, raw materials exempted from VAT, Source: <http://bit.ly/2dGMXzq>

<sup>21</sup> TAK, list of t/p that were approved for exemption of VAT on importation of goods, VAT exempted information technology equipment, Source: <http://bit.ly/2dFCS4Y>

efficiency or cost of businesses. Based on TAK data, the turnover of businesses that have benefited from the exemption from VAT has increased by about 5%.<sup>22</sup>

Another requirement of businesses with regard to fiscal policies that affect the production cost is the abolition of customs duties on raw materials and presentation of tax breaks for new investments. Recently, the Government of Kosovo has exempted from customs duties the coke oil which is used as a raw material especially by the construction material producers.<sup>23</sup>

**Lowering of the registration threshold.** For the purpose of reduction of informality and inclusion of more businesses in the framework of VAT, the applicable Law on VAT has lowered the threshold of registration for VAT. According to the previous law, if a business has realized supplies less than €50,000 in a calendar year, then such business was not required to be VAT registered.<sup>24</sup> With the new law, a business must register for VAT if it exceeds turnover over €30,000, while the part of turnover exceeding this amount will be taxed for VAT purposes.<sup>25</sup> With the entry into force of this law, the number of businesses registered for VAT has increased significantly. Prior to the entry into force of the law, the monthly average of new businesses registered for VAT were 163, while after entry into force of the law this average increased to 326.

Although the lowering of the VAT registration threshold can increase the red tape for small businesses, this change was supported by business representatives for the reason that it reduces informality, being that more businesses are included in the VAT declaration framework.<sup>26</sup> On the other hand, the lowering of the VAT registration threshold represents a need for an increase in the number of TAK inspectors, because as mentioned above the number of registered businesses has increased, therefore more businesses now have to be inspected whether they are declaring VAT appropriately.<sup>27</sup> Although the number of registered businesses has increased, the number of tax inspectors in TAK reduced for five in 2015 (from 291 to 286).<sup>28</sup> Besides the number of inspectors, TAK must invest in increasing their professionalism.<sup>29</sup>

**Reimbursement.** According to the new administrative instruction, if according to the TAK assessment, a business overstates the VAT refund claim, then such business is obliged to submit a new application or

<sup>22</sup> TAK, Response via e-mail, 27 September 2016

<sup>23</sup> Government of Kosovo, Decision no. 04/109, Source: <http://bit.ly/2dgrvEE>

<sup>24</sup> Official Gazette, Law no. 03/L-147 on Value Added Tax, Article 6.1

<sup>25</sup> Official Gazette, Law no.: 05/L-037 on Value Added Tax, Article 6.1

<sup>26</sup> American Chamber of Commerce, Interview with Visar Hapçiu, 22 September 2016

<sup>27</sup> Deloitte Kosova, Interview with Ruzhdi Zenelaj - Taxes Manager, 27 September 2016

<sup>28</sup> TAK, Work Report January - December 2015, Source: <http://bit.ly/2dh7YAt>

<sup>29</sup> Deloitte Kosova, Interview with Ruzhdi Zenelaj - Taxes Manager, 27 September 2016

claim for crediting to be transferred to the following periods.<sup>30</sup> This represents an additional requirement of what is regulated by law. Furthermore, this restriction is a problem for businesses because the procedures of reimbursement can prolong. Application for refund may take more time to review due to involvement of regional and central TAK officials. Recently, a problem for businesses is also that a payment must be carried out in the same period of invoicing in order to request reimbursement.<sup>31</sup> Due to the short period of time available for comments, dissatisfaction regarding the drafting of this administrative instruction was also expressed by business representatives.<sup>32</sup>

**Financial transactions.** Law on VAT exempts from VAT financial transactions such as issuing a loan or activities in the investment fund management without any restriction as to what institution they are performed by.<sup>33</sup> According to the Administrative Instruction, exemption from VAT in these activities is allowed only if they are performed by a financial institution.<sup>34</sup> As in the case of reimbursement, the administrative instruction presents conditions beyond the law requirements. This limitation presents problems for branches of companies in cases when they take loans from parent institutions - that are not financial institutions, because they are obliged to pay VAT.<sup>35</sup> Besides that it increases the cost of financing for businesses, it also creates more favourable conditions for financial institutions compared to other non-financial businesses.

<sup>30</sup> Administrative Instruction No. 03/2015 on Implementation of Law no. 05/L-037 on Value Added Tax

<sup>31</sup> Deloitte Kosova, Amendments to legislation on VAT, Ruzhdi Zenelaj - presentation

<sup>32</sup> American Chamber of Commerce, interview with Visar Hapçiu, 22 September 2016

<sup>33</sup> Official Gazette, Law no. 05/L-037 on Value Added Tax, Article 28, paragraph 1.2 and 1.7

<sup>34</sup> Administrative Instruction No. 03/2015 on Implementation of Law no. 05/L-037 on Value Added Tax, Article 44.1

<sup>35</sup> Deloitte Kosova, Amendments to legislation on VAT, Ruzhdi Zenelaj - presentation

## 6. Conclusions

This study has analysed the effects of amendments in the Law on VAT in the budget revenues, consumer prices and business activity. While the VAT has been reduced in a small number of products, VAT of 18% has been introduced in most of the products. This has reflected positively in customs and domestic revenues. According to our calculations, only from the VAT increase, Kosovo Customs has collected an average of about extra €4.5 million per month during the period September 2015 - August 2016. On this level of import, during the year 2016 Customs can collect around €54 million more revenues from VAT increases from 16% to 18%. While the raise of VAT rate has increased budget revenues, this means that the budgets of households has become poorer. However, due to the lower import prices, the increase of the VAT rate has not reflected in the increase of consumer prices.

Reducing the VAT in some products has affected negatively budget revenues, but the application of VAT on medicines and import growth in these products has compensated this loss. On the other hand, the reduction of the VAT at domestic revenues seems to have had a higher negative effect on revenues. Regarding the impact of reduced VAT on the consumer prices, the data suggest that this policy has not been able to have a direct impact on their reduction thereof.

Representatives of businesses have largely supported the amendments that have taken place in the new Law for the VAT. Abolition of the VAT in raw materials and production machinery has reduced the initial investment costs. In addition, businesses were enabled to reimburse investments in production machinery, which policy has been also strongly supported by manufacturing businesses.

Lowering of the threshold for VAT registration of businesses was also welcomed by businesses, due to the reduction of informality and consequently creating the necessary preconditions for an equal competition among businesses. Although the lowering of the threshold has increased the number of businesses registered for VAT, TAK has not increased the number of inspectors. In addition to the increase of number of inspectors, business representatives have requested the increase of professionalism of existing inspectors.

Lastly, the representatives of businesses have positively evaluated the cooperation with the Government of Kosovo in the process of drafting the Law on VAT, but they are unhappy with the time available for review of administrative instructions. Some of the things they have submitted remarks about include: the reimbursement procedures, abolition of the VAT from financial transactions, reverse charge etc.

Based on the findings mentioned above, GAP Institute recommends:

- In addition to the VAT reduction for some products and services, the Ministry of Finance should introduce exemptions from direct taxes for certain categories of citizens as more effective measures for income redistribution;
- In order to ensure equality in the market among businesses, TAK must ensure that for the same consumption products, the VAT rate applied is the same;
- The Ministry of Finance should review Administrative Instruction no. 03/2015 on Implementation of Law no. 5/L-037 on Value Added Tax in particular to shorten the period and review the conditions for VAT reimbursement;
- With the aim of promoting investments for companies that can take loans from the parent companies, the Ministry of Finance should exempt companies from VAT in financial transactions;
- The Ministry of Finance should begin with gradual exemptions from customs duties for raw material starting with materials which may have larger effects in reducing the cost of production. This measure reduces production costs for Kosovar businesses and enables them to become more competitive with import products;
- The Ministry of Finance should introduce tax breaks as a way to promote new investments which can generate new jobs and reduce the trade deficit;
- The Ministry of Finance should allocate budget for the increase in the number of inspectors for TAK, as a measure to reduce informality;
- In order to ensure equal competition in the prices of information technology with the prices of these products in countries in the region, the list of IT products included on the list of products with reduced VAT should be expanded;
- TAK must ensure that inspectors have the necessary skills and sufficient knowledge of the legal basis in order to facilitate business cooperation with the TAK. For this reason, TAK must organize regular training and testing of the staff.





GAP Institute is a Think-Tank established in October 2007 in Kosovo. The main goal of GAP is to attract professionals in order to create an environment of professional development and research, which is encountered in similar institutions in western countries. This also provides the opportunity for the people of Kosovo to research, develop and implement projects with the aim of advancing the Kosovar society. The priority of this Institute is to mobilize professionals in addressing the economic, political and social challenges of the country. The main goals of GAP are to fill the gaps between the Government and the citizens, and also fill the gaps between problems and solutions.

**GAP Institute is supported by:**

