

## **TECHNICAL NOTE**

### **ON THE REFUND OF THE VALUE ADDED TAX (VAT) 2015-2016**

**Tirana, November 2016**

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## **ABBREVIATIONS**

ALL	Albanian Lek
DCM	Decision of the Council of Ministers
GCD	General Customs Directorate
GTD	General Tax Directorate
IMF	International Monetary Fund
IC	Investment Council
MoF	Ministry of Finance
APR	Active Processing Regime
VAT	Value Added Tax
WTO	World Trade Organization

## I. INTRODUCTION

Value Added Tax is one of the main sources of revenues to the State Budget, constituting circa 75% of the revenue line from taxes and customs, or circa 9.1% of the GDP, according to the state budget for 2015 and 2016<sup>1</sup>. Due to this, the VAT management is a sensitive issue for the tax administration in meeting its objectives and for businesses that are subject to this obligation. VAT, as a consumption tax which is carried forward to the final user of goods and services, creates opportunities for businesses that pay VAT and which result to have recoverable VAT amount, to receive it back through refund procedures detailed in the applicable legal framework.

According to the IMF<sup>2</sup>, experience from many countries regarding implementation of VAT refund procedures has shown that the VAT refund has been the “Achilles’ heel” of the VAT system. Meanwhile, untimely and delayed refunds, as well as bureaucratic procedures, have been a source of tension between the tax authorities and businesses. This is due to the fact that the VAT nature changes from a tax on final consumption to a tax on production when the tax authorities delay/refuse approval of legitimate business applications for VAT refund. This is why VAT policymakers should reciprocally set the same “*binding measures*”, legal and administrative deadlines as those requested to be respected by businesses when paying VAT.

Timely VAT refund has a direct impact on business activities, because it leads further to liquidity for daily operations and reduced investment cost. This is important not only for exporters, but also for entrepreneurs that execute large capital purchases (investments) in relation to sales, which can be limited, especially at the first steps of the business, or extended in time.

Meanwhile, the Albanian Government has made legal and institutional changes during 2014-2016 in order to address the concern, continuously raised by businesses, over VAT refund obstacles, with the final aim of easing refund procedures for taxpayers in general and for exporters in particular.

While addressing business problems in 2015, especially problems related to Tax Control and Informality, the Secretariat identified the need for prompt VAT refund with the least possible administrative burden. The object of this analysis is to assess the performance of the current VAT refund model, considering recent legislative changes and businesses’ experience, especially during 2015-2016. To this end, we have relied on the best regional and EU practices, on reports of international institutions such as the IMF and OECD on addressing VAT refund in the context of fiscal policies and management. For purposes of this paper, a Survey was conducted online during September 5 – October 31 2016. Survey responses have contributing in drafting this paper. Preliminary findings were discussed in advance with a group of fiscal experts and businesses, subject to VAT refund during 2015-2016.

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<sup>1</sup> Ministry of Finance, *Law on State Budget, 2015 and 2016*

<sup>2</sup> IMF Working Paper, *VAT Refunds: A Review of Country Experience*, Graham Harrison and Russell Krelove, November 2005

## II. CONTEXT

Long delays in refunding VAT were among the major problems identified by the business community until mid 2013. According to claims from businesses in the media, or discussion and consultation platforms, VAT refund procedures were considered and perceived as bureaucratic, where refund was executed on selective grounds, corrupt practices and was conditioned from the tax administration plan on meeting projected revenue targets. Following 2013, the tax administration discovered some abusive schemes related to VAT refund. *According to the EU Progress Report for 2016, circa 116 cases of tax fraud and tax evasion were reported to the public prosecutor during September 2015 – July 2016*<sup>3</sup>. In the meantime, failure to refund the VAT for years resulted in a chain of debts of businesses, mainly exporting businesses but not only, to suppliers and banks which resulted directly in increased lack of trust on the state and limited financial resources for investments.

In 2013<sup>4</sup>, the Government admitted that failure to refund the VAT or late refunds were major problems to businesses. An audit on late payments of the State to businesses identified a debt of 72.57 billion ALL. According to this audit, the line for VAT refund alone, that the State owed to businesses, was 12.84 billion ALL, or circa 18% of the total late payments. For the first time the late payments of the state to businesses, including those related to the non-refunding of the VAT, were acknowledged officially following the approval of DCM No. 50, dated 05.02.2014 *“On the adoption of the Arrears Clearance and Prevention Strategy and action plan.”*

The adoption of such a strategy was an expression of the serious commitment of the Government to settle arrears as soon as possible in a correct, transparent and reliable manner, as well as to strengthen fiscal discipline in order to prevent new liabilities accrued in the future<sup>5</sup>. This strategy was intended to not only ensure better improved finances as part of the obligations of the Albanian Government to the IMF in the context of mid-term program of assistance<sup>6</sup> from this institution, but also to establish a new partnership relationship with the business community. According to the Ministry of Finance, by 31 December 2015, circa 18 billion ALL were paid in total for the VAT refund alone.

The achievement of the above objectives was supported by changes in the legal framework, namely: amendments to the law “On Value Added Tax”, changes to tax procedures and related guidelines<sup>7</sup> that provided *clear deadlines* within which the administration must meet its obligation to refund VAT to businesses. Such refund must be executed within 30 days from the application of exporting taxpayers and within 60 days for all other taxpayers.

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<sup>3</sup> *European Commission, Albania 2016 Progress Report, Nov.2016*

<sup>4</sup> *In September 2013 the Government started to assess late financial obligations.*

<sup>5</sup> *Commitments of the government program – economic development pillar: “On the payment of outstanding refundable VAT amounts”;*

<sup>6</sup> *Ratification of the IMF loan - Law No. 33/2014 “On the approval of the loan of 295 420 000 Sdr-Sb, that the International Monetary Funds grants to Albania for the 36-months Support Program. (EFF)” and Memorandum of Economic and Financial Policies.*

<sup>7</sup> *Law No. 92/2014 “On VAT” entered into force on January 1 2015 and was amended by Law No. 90/2015, whereas Law No. 9920 dated 19.05.2008 “On tax procedures in the Republic of Albania” was amended by Law No. 92/2015.*

Later on, DCM No.460 dated 22.06.2016 provided also *automatic VAT refund* (without risk control/analysis) for exporters the value of the exports of which amounts to more than 70% of the total sale value during the tax period/periods for which refund is applied, being considered thus as zero risk taxpayers. According to the Ministry of Finance the effects of this new provision extend to over 1050 enterprises that constitute 40% of the total exporting companies in the country. The prompt payment of accrued liabilities to businesses, including accrued recoverable VAT, as well as identification of fraudulent fictitious VAT refunds with considerable financial impact on the state budget, intended to show serious commitment of the Government and assist in restoring confidence in state mechanisms, especially in relation to easing restrictions of liquidity in the private sector.

## 2.1 METHODOLOGY

The steps taken by the Secretariat to bring to the attention of the Investment Council proceedings on VAT refund as follows:

- *Desk research on the applicable legislation* on VAT refund and its dynamic, as well as models set forth in the legislation of some EU countries. This was done to identify qualitative changes adopted for purposes of easing the VAT refund process.
- Conduct online a *Survey (Annex B)* for VAT taxpayers. This Survey was filled in anonymously by businesses that shared their direct experience with the tax administration in relation to VAT refund procedure. The Survey contained close and open questions to be answered during September 5 – October 31, 2016. **The Survey was filled in by 77 businesses, 40% of which of foreign capital, 80% with exporting activity, 60% with exports exceeding 70% of sales. The most representative sectors in the Survey are Processing Industries with 56%, Trade with 27% and Services with 24%. Also, 55% of Survey respondents have filed for VAT refund during September 2015 – October 2016.** According to the answers in the survey, 63% of VAT refund applications are filed by exporting taxpayers, 16% by taxpayers with a recoverable VAT amount from investments and 21% by other taxpayers. The survey had a specific section where businesses could identify some of the problems faced in doing business. The most typical problems identified, also confirmed by experts of the area, have been included in this paper under section 3.7: Other findings.
- *Meetings and face-to-face interviews* were held with the Chambers of Commerce and Industry across the country<sup>8</sup>. In total, held 27 consultation meetings.
- The findings were consulted in focus groups with businesses and fiscal experts. 2 meetings were held to this end: one with the business community (12 businesses) in cooperation with the Chamber of Commerce and Industry in Elbasan and a joint meeting with fiscal experts and business associations in Tirana. Consultations with businesses were held in cooperation with the Chamber of Commerce in Gjirokastra, Durrës, Fier, Shkodër, associations and both, independent and administration's fiscal experts.

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<sup>8</sup> Durrës, Elbasan, Gjirokastrë, Fier, Shkodër.

## 2.2 APPLICABLE LEGAL FRAMEWORK

Albanian legislation which addresses, among others, issues related to VAT refund is as follows:

- Law No.92/2014 “On Value Added Tax” (amended)
- MoF Instruction No. 6 dated 30.01.2015 “On Value Added Tax” (amended)
- Law No.9920 dated 19.05.2008 “On Tax Procedures” (amended)
- MoF Instruction No.24 dated 02.09.2008 “On Tax Procedures” (amended)
- DCM No. 953 dated 29.12.2014 “On implementing provisions of Law No. 92/2014, “On Value Added Tax in the Republic of Albania” (amended)
- DCM No. 460 dated 22.06.2016 “On an amendment to DCM No.953 dated 29.12.2014”

### **Conditions and deadlines**

1. ***Law No. 92/2014 “On Value Added Tax” (amended)*** sets forth cases when a taxpayer can apply for VAT refund.

*The general criteria*<sup>9</sup> that must be met by a taxpayer to request VAT refund are as follows:

- a) The taxpayer must have carried forward a recoverable VAT amount for 3 consecutive months;
- b) The total amount requested for VAT refund exceeds 400,000 (four hundred thousands) ALL.

In the case of exporters<sup>10</sup>, it is stipulated that they are entitled to apply for VAT refund when their recoverable VAT amount exceeds 400,000 (four hundred thousand) ALL. DCM No. 953 dated 29.12.2014 “On implementing provisions of Law No. 92/2014, “On value added tax in the Republic of Albania” provides details on categories of exporters. Prior to processing an application for VAT refund for a taxpayer, the tax administration is entitled to demand that the taxpayer proves the purpose of the economic activity is to execute taxable transactions that entitle that taxpayer to VAT deduction.

The tax administration carries out the refund procedure, pursuant to the rules set forth in Law No. 9920 dated 19.05.2008 “On tax procedures” (amended) with VAT refund deadlines being:

- a) within 60 days of a taxpayer filing a request<sup>11</sup>;
- b) within 30 days of an exporter filing a request.

2. ***DCM No. 953 dated 29.12.2014 “On the implementing provisions of Law No. 92/2014, “On Value Added Tax in the Republic of Albania”*** among other things, foresees in detail in Article 10 the categories of exporters, for purposes of VAT refund procedures, as well as the criteria on the grounds of which the tax administration identifies them.

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<sup>9</sup> Article 77 paragraph 1

<sup>10</sup> Article 77 paragraph 3

<sup>11</sup> All other taxpayers except for exporters

Currently, for VAT refund purposes, categories of exporters are taxpaying exporters, as well as taxpayer persons who re-export foreign goods under the *active processing regime* in the Republic of Albania, as set forth in the Customs Code, who concurrently meet the following criteria:

- a) The value of the exports during the tax period/periods for which refund is requested constitutes more than 70% of the total sale value, including exports;
- b) Have more than 1 year of export activity;
- c) Present the export declaration form issued in accordance with the Customs Code of the Republic of Albania, as evidence for having carried out the export;
- c) Do not have any unpaid social and health insurance contributions.

The DCM sets forth two procedures on VAT refund according to the degree of risk which can also be found summarised in graph 1 below:

- a) *Automatic refund*<sup>12</sup>: According to the DCM, taxable persons who meet the above criteria are automatically refunded<sup>13</sup> within 30 days from the day of the submission of the VAT refund application, as *zero risk taxpayers*.
- b) *Refund on the grounds of Risk Analysis*<sup>14</sup>:
  - Taxable persons, with a proportion of exports to the total sales, of more than 50% to 70% during the period/periods for which refund is requested, are refunded within 30 days from the day of the filing of the VAT refund application, while becoming subject to the risk analysis procedure first.
  - If the risk analysis finds that the taxable person that is classified under this category must undergo the tax control procedure, the entire procedure, including the control, is completed within 30 days from the day of the filing of the application. On the contrary, the refund is executed through State Treasury system within 30 days from the day of the filing of the refund application.
  - All other taxable persons that carry out exports but do not meet any of the above conditions<sup>15</sup>, are refunded within 60 days from the day of the filing of the refund application while becoming subject to the risk analysis procedure.

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<sup>12</sup> As per amendments effected with DCM No. 460 dated 22.06.2016

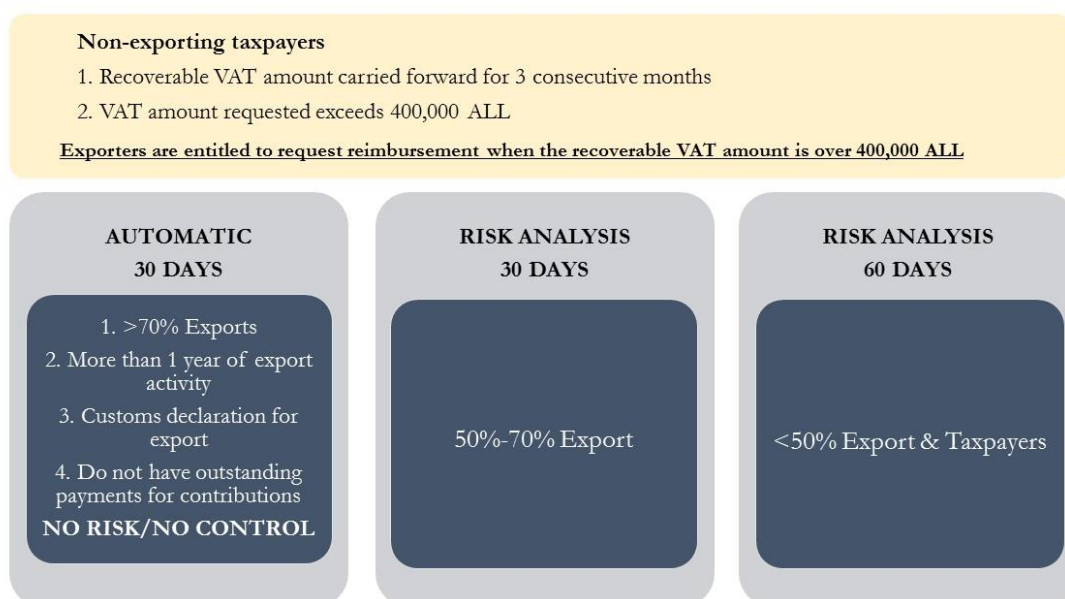
<sup>13</sup> It is assumed to be without control by the tax administration

<sup>14</sup> As per amendments effected with DCM No. 460 dated 22.06.2016

<sup>15</sup> The conditions set forth in paragraphs 1 and 3 of Article 10 of the DCM

**Chart 1: Conditions and deadlines**

## VAT Refund



### Administration and procedure

3. **Law No.9920 dated 19.05.2008 “On tax procedures” (amended)**, determines the relevant bodies that will follow the implementation of the VAT refund procedures<sup>16</sup>.

Concretely:

- a) The taxpayer electronically files the application for the VAT refund<sup>17</sup> which goes to a centralised structure, the VAT Refund Department at the General Tax Directorate.
- b) The Vat Refund Department, in cooperation with the Regional Tax Directorate the taxpayer is registered at, verifies the tax situation of the taxpayer and approves the recoverable VAT amount. When necessary, the tax administration conducts controls based on the risk analysis.

The 2015 amendments<sup>18</sup> to Law No. 9920, concrete **deadlines were clearly set for the first time** about refundable VAT amount as well as **additional guarantees** for the taxpayer about his rights in relation to the tax administration, providing for an honest relation that must be established between businesses on one hand and the administration on the other. Concretely, article 75/1 stipulates that: “The payment of the recoverable VAT amount shall be carried out within five days, through the treasury system, based on the rules set forth in the instruction of the Ministry of Finance. On the contrary, the taxable person shall be entitled to be exempted from other tax liabilities to the amount of the VAT claimed for refund”.

4. **Instruction No. 24 dated 02.09.2008 (amended)**, provides details on the concrete application of the above provisions in regards to the VAT refund, from the moment of

<sup>16</sup> Article 75/1

<sup>17</sup> <https://www.tatime.gov.al/sq-al/Pages/Video-Gallery.aspx>

<sup>18</sup> Amendments to Law No. 91/2015, dated 23.07.2015

the taxpayer filing the request up to the moment the payment is executed through the treasury<sup>19</sup>.

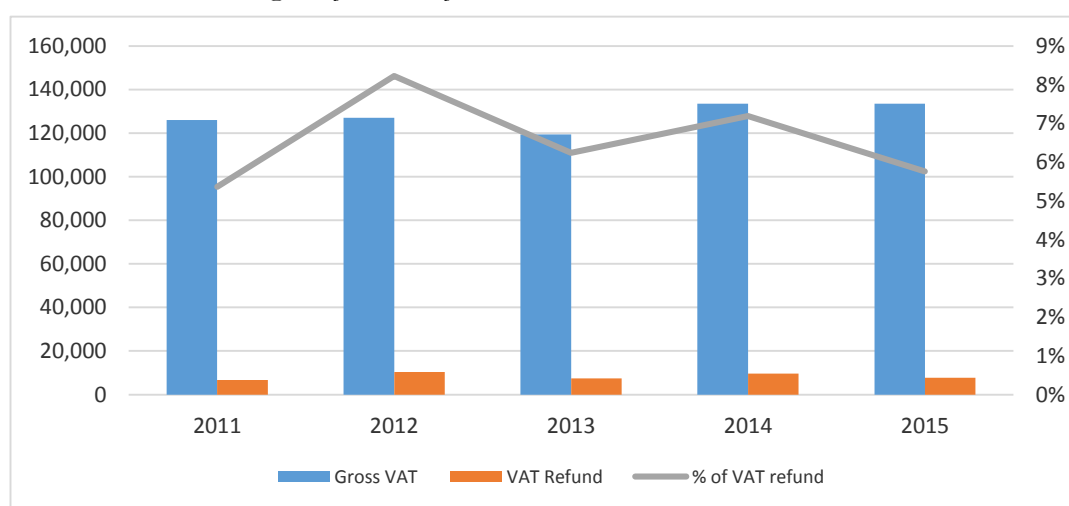
The GTD used to utilize certain Internal Rules of Procedure for VAT refund, also published online,<sup>20</sup> that were in line with the legal framework until the end of 2014, but which were fully abrogated following the amendments of the last two years, as described above. Currently, there are no Rules of Procedure on VAT refund procedures that reflect the applicable legal framework.

### III. FINDINGS

VAT refund remains an important indicator in the doing business climate. According to the World Bank Report “Doing Business 2017” the *postfiling index*-part of the *Paying Taxes* indicator-for the first time includes VAT refund applications. *Albania has received a satisfactory score (83 points) vis-à-vis the best model, Estonia (98.5 points), but lags behind countries in the region, such as Croatia, Macedonia and Montenegro.* Considering that this indicator is included for the first time in the Doing Business methodology, the progress of Albania in relation to this indicator remains to be seen in the years to come.

According to IMF studies the more developed a country is the higher the level of refunded VAT vis-à-vis gross VAT value, amounting even at 40% of the gross VAT value<sup>21</sup>. Data from the Ministry of Finance for 2011 -2015 on fiscal indicators show that VAT refund has a minor role in the total gross revenue values generated from VAT.

Chart 2. Progress of VAT refund vis-à-vis Gross VAT value, 2011 - 2015



Source: Fiscal analytic indicators, Ministry of Finance

<sup>19</sup> The detailed procedure was set forth by MoF Instruction No.14/1 dated 04.09.2015

<sup>20</sup> <https://www.tatime.gov.al/sqal/Legislacioni/Vendime%20Teknike/Documents/Rregullore%20per%20rimbursimin%20e%20T%20VSH-se.pdf/#search=rimbursim>

<sup>21</sup> IMF, VAT Refunds: “A Review of Country Experience”, 2005

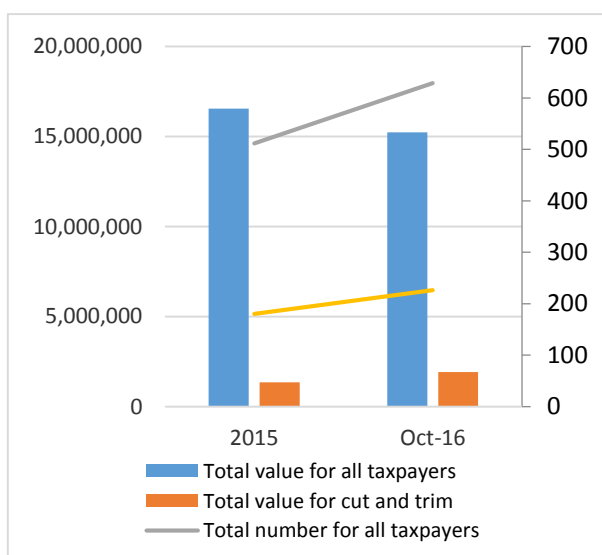
As presented in the above graph, the value of refunded VAT has fluctuated over time from 6%-8% vis-à-vis the total gross VAT value. According to most recent data from the Ministry of Finance, VAT refund for January – August 2016 has reached to 5,504 million ALL with a growth of 22% compared to the same period of 2015, i.e. circa 6% of the gross VAT value collected from tax and customs offices.

Most recent data from the GTD point out an increased number of refund applications during these 10 months of 2016 as compared to the 12 months of 2015, both for businesses operating in the active processing regime<sup>22</sup> (APR), as well as for all other taxpayers.

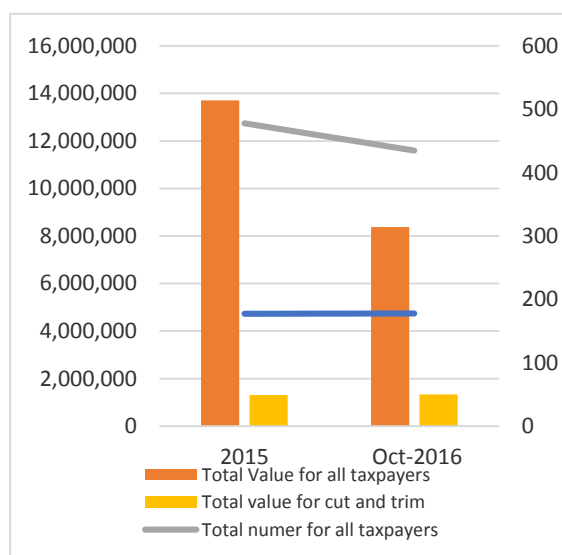
- The number of approved applications for 2015 was 94% of the total requests filed by taxpayers. For APR businesses this level was 99%.
- Refund in the case of approved applications has been executed 100% for both periods.

Graphs below present a reflection of requests and factual refunds in number and value for all taxpayers generally and APR businesses specifically, for 2015 and 2016 (until October).

*Chart 3. Requests for VAT refund in number and value (thousand ALL)*



*Chart 4. Actual VAT refund in number and amount (thousands ALL)*



*Source: General Tax Directorate 2016*

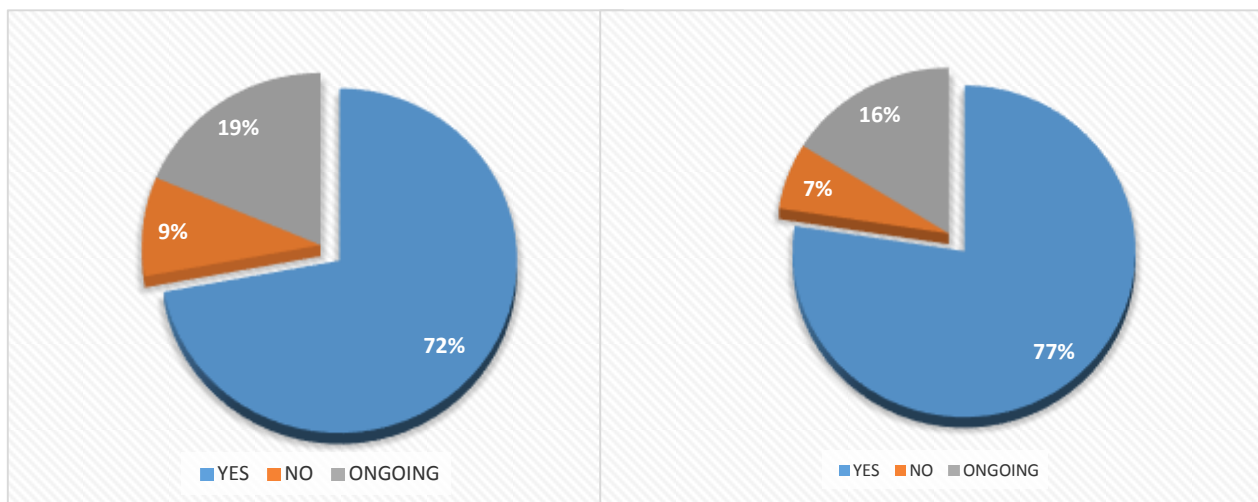
The analysis conducted by the Secretariat, based on the Survey results and consultation meetings, found that VAT refund procedures have improved both in the formal and practical sense. Thus, 54% of respondents confirm that the VAT refund application procedures have been simplified. Also, 72% of those who said that they have filed an application confirm that the application has been approved and that they have received the VAT refund.

<sup>22</sup> Active processing is an economic customs regime the main purpose of which is to export labour, technology and other economic factors which simply or finally transform goods into goods ready to be used as products in other processing, assembling operations or for consumption. The procedure allows the use of non-Albanian goods into the customs territory of the Republic of Albania, in one or more processing operations if they are exported outside the customs territory of the Republic of Albania in the form of compensating products. The active processing regime allows the processing of non-Albanian goods destined for re-export in the form of compensating products: i) without payment of customs duties (suspension system), or; ii) reimbursement after their re-export (refund system).

**Chart 5: Have you received VAT refund?**

a) All taxpayers

b) Exports above 70%



*The data has been processed by the Secretariat based on the answers to the Survey, November 2016*

**Main comments from businesses participating in the Survey and during meetings held with them and experts of the area focus on the following:**

### **3.1 The VAT refund criteria are considered harmonised, but secondary legislation needs to be updated (MoF Instruction No. 24, dated 02.09.2008)**

Criteria for VAT refund are generally harmonized in legislation. However, criteria set forth in the secondary legislation and concretely in the Minister of Finance's Instruction No.24 dated 02.09.2008 "On tax procedures", point 75/1, are not the case. These criteria have not been updated in line with the provisions of DCM No. 460 dated 22.06.2016. The Instruction reads: *"If the taxpayer is not a zero risk exporter (100% exporter), but it goes through the active processing regime, or is an exporter in more than 60% of the total sales value, then it shall be refunded within 30 days, while being subject to the risk analysis"*. Meanwhile DCM No.460 dated 22.06.2016, which was issued later on and was drafted in the context of the Government's package to encourage exports and to increase liquidity at their disposal, stipulates that zero risk exporters shall be considered those exporters who besides general conditions meet concurrently the condition to export more than 70% and not necessarily 100% of the total sales value. The other exporter's category which shall be refunded within 30 days and on the grounds of the risk analysis is that of taxable persons who export from **50% to 70%**, not the one for those who export over 60% of their total sales value.

*This discrepancy is the result of interventions, at different times, in the above by-laws that are part of the legal framework architecture which regulates fiscal matters. Regardless of this discrepancy, the tax administration directly applies the criteria set forth in DCM No. 460. We must underline that a considerable number of businesses that participated in the Survey, or which attended meetings with the Secretariat, were still referring to the old criteria pursuant to the specifications of Instruction No. 24.*

During meetings of the Secretariat with the GTD and MoF, it was found out that institutions are aware of this discrepancy and that it is expected that to be remedied by the final amendments to Instruction No. 24 that will also reflect some other additions and changes of the tax procedures, which were being discussed until recently and which were finally adopted by the Assembly of Albania on 03.11.2016.

### **3.2 There is improved awareness regarding refund (2015-2016), however meeting VAT refund deadlines remains a challenge for the administration**

Almost all stakeholders, businesses and experts contracted by the Secretariat found that there is improved awareness “of the administration in carrying out VAT refund in compliance with legal deadlines”. Regardless of this, answers to the Survey (September-October 2016) indicate that in a considerable number of cases refund has been executed after the expiration of 30 and 60 days deadlines. Thus, the results of the Survey show that in 54% of cases the refund was executed after the lapse of 60 days. Only 11% of respondents said that refund within 30 days was completed for businesses “exporting more than 70% of their total sale value”. The GTD confirms that during 2016 only 13 applications have been approved within 30 days and 174 within 60 days and that in many cases delays result from the actual lack of administration’s ability to conduct the control, to write the report within 30 or 60 days, especially when the taxpayer’s transactions are complex.

### **3.3 Current VAT refund procedures are considered as simplified when compared to previous years**

More than 56% of businesses responding to the survey consider the VAT refund procedure to be simplified as compared to the procedure prior to 2015. We underline that VAT refund procedures have been specified in details under point 75/1 of Instruction No. 24<sup>23</sup>. Point 75/1 describes not only elements that must be followed by the taxpayer from the moment they fill in the refund application, but also steps that the tax administration must take from the moment it receives the application till its approval. These provisions provide for a more transparent VAT refund system due to increased accountability of the tax administration to taxpayers. In the meantime, the centralization of the process in its entirety at the GTD’s VAT Refund Department enables for a more rigorous control of the VAT refund applications through the risk system.

### **3.4 Large number of controls from the tax administration regarding VAT refund applications.**

*It is worth noting in advance that DCM No. 460 dated 22.06.2016 (which provides for automatic refund within 30 days for exporters exporting more than 70% of their total sale value) entered into force only on June 28, 2016. As such, its real impact in decreasing the number of tax controls from the administration for this category of exporters will be better identified during 2017.*

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<sup>23</sup> These amendments were done by Instruction No. 14/1, dated 04.09.2015. Published in the Official Journal No. 156 on September 07, 2015

Currently, according to the results of the Survey, 87 % of all entities that have applied for VAT refund, were subjected to VAT tax controls, including “over 70%” exporters (in 88% of cases in the Survey). This fact is confirmed by the outcome of interviews and meetings that the Secretariat held with businesses. Meanwhile, a very small number of businesses, mainly from the apparel industry, have declared to have benefited from the **automatic** VAT refund, i.e. within 30 days and without controls. GTD data also point at a very low number of automatic refund cases, to be specific, 5 cases for 2015 and 11 cases for 2016.

According to the applicable legal framework, tax control is not always requisite, but only when *it results to be necessary from the risk analysis*. Instruction No. 24, point 75/1.1 reads: “*When necessary, in accordance with the risk analysis, the VAT Refund Department, which reviews the refund application and carries out the refund procedure as a whole, shall request that the pertinent Regional Tax Directorate conducts a tax control prior to approving the refundable amount*”.

Businesses are concerned over the high number of controls that the administration generally, and tax administration specifically, carry out; controls conducted by the tax administration following their VAT refund application are bureaucratic, especially when these entities were subjected to a thorough tax control soon before. According to data from the General Tax Directorate fraudulent applications discovered during controls on VAT refund remain quite low at 4.3% of the controls for 2015 and 3.4% for the 10 months of 2016. This figure can be interpreted in a way as evidence of businesses’ responsible actions when applying for VAT refund to ensure they are strictly in line with the applicable legislation.

*The fact that the number of controls remains high and concerning for businesses leaves room for discussions on the efficiency of the risk analysis system initiated in 2015 and the criteria that the administration uses for this system.* It is deemed as necessary, a more detailed analysis with a focus on the efficiency of tax checks on VAT refund, the proper use of the risk analysis system, the exchange of information between tax and customs administration, especially in relation to active processing regime activities and overall efficiency of the administration’s resources.

### **3.5 There is some improvement (over 40% of the Survey respondents rated as "somewhat good" and 30% as "good") the relationship business-administration**

There is some improvement in general on the business opinion about the behaviour of tax administration not only in the framework of VAT refund. Therefore, according to the Survey’s data, the work of tax administration regarding the requests for refund has been rated as "somewhat good" by 40% of the respondents and as "good" by 31% of respondents.

On the other side, it is noted a kind of hesitation from a group of businesses to apply for VAT refund even on cases when they have enough recoverable VAT amounts for refund. According to the Secretariat’s Survey, in the responses of those who have not applied for VAT refund, 32% of them state "lack of trust" for Vat refund, while 42% of them state other reasons such as "fear" that if they apply for VAT refund they will have to undergo for sure a tax inspection and very likely to be penalised by the tax inspection.

There is still a perception from the business that inspectors during an inspection have the objective to reduce as much as possible the recoverable VAT amount to be refunded to the business. For this purpose, some vain reasons and justifications unbased on the legislation<sup>24</sup> are

<sup>24</sup> Reasons also unaccepted by various decisions of the Administrative Courts

used, such as: ignoring invoices due to small formal mistakes; accept VAT only as recoverable and not refundable with the claim that the business has not made any sales in relation to this purchase, but instead keeps it still in inventory/storage (e.g. in the trade of cigarettes and cement); ignoring recoverable VAT for pre-payment invoices although there is a justified documentation (e.g. order contracting or contractual engagement between typical parties in the sector of construction) etc. Such cases are in particular more evident when refund requests are of substantial amount of money. E.g. in the case of taxpayers who exercise their economic activity upon concessionary contracts in the sector of energy and for this purpose make new investments. In some cases, tax administration has not acknowledged some expenditures for works done (streets, bridges) in function of the economic activity with the reason that *“the investment value despite being proved with regular invoices, goes beyond the concessionary contract and consequently not in function of the economic activity.”*

Asked during consultations, businesses and independent expert of the area relate this fact also with the conditionality of the tax administration to fulfill the monthly revenue plan. According to them, it is this plan which perhaps "conditions" the behaviour of the administration toward businesses and consequently the approval or not of the requests and the actual VAT refund within the legal deadlines mentioned above. Meanwhile, based on the Survey and on the consultations held with the business, e.g. during meetings with some investors in the energy sector, there still persist the issue of "delays and non approval of VAT refund related to expenditure occurred during project design and development stage."

### **3.6 Businesses outdated information because of the dynamics of legal changes. Continuous communication administration – business to enhance the compliance of businesses regarding the tax system – still insufficient.**

Based on consultation meetings held with businesses, it came out that many of them, for example in Elbasan, did not have all the necessary information on applicable VAT refund procedures, or risk system operation and legal amendments in this area during the last years. We learned from interviews with some of them that businesses request information in traditional ways, for example, they directly contact the tax administration instead of using updated information on amended legislation, or the *video-demonstration* in the official webpage of the GTD<sup>25</sup>. They admitted that they decided whether to file an application for VAT refund or not after personally contacting the tax administration. In most cases they had given up the VAT refund application from fear of tax controls, not receiving, thus, needed information on the automatic refund opportunities in cases when they classified as businesses exporting over 70% of their total sales value. Lack of information on updated legislation and applicable procedures is also noticed among the administration itself<sup>26</sup>, experts or associations that defend the interests of a certain category of businesses as a whole. This is not only due to the dynamics the legislation goes through in Albania, as the Secretariat has previously identified<sup>27</sup>, but it is also the result of inadequate education and a mentality according to which efforts are made to avoid official

<sup>25</sup> <https://www.tatime.gov.al/sq-al/Pages/Video-Gallery.aspx>

<sup>26</sup> In one occasion, during a tax inspection carried out in 2016 for an APR entity, the tax inspector had requested the order for the release of goods from the customs, as a justifying document. Meanwhile, MoF Instruction No. 6, dated 30.01.2015 "On VAT" and DCM No. 953, dated 29.12.2014 specify that the customs declaration is the only justifying document for exporters.

<sup>27</sup> Refer to customs control

communication with the administration. Preliminary studies conducted by the Secretariat found out that 1457 officials of the tax administration have been trained during October 2015 – March 2016, while there is as well a training program for 2016. We would suggest including specific training on the dynamics of changes regarding VAT refund procedures (GTD webpage).

### **3.7 On Business Climate - Other findings**

The following findings have been identified by businesses themselves when filling in Section III of the Survey on the problems in doing business in Albania, and by the Secretariat during meetings and focus groups. To enable a comprehensive analysis of findings with the objective to bring a more accurate information in this Technical Note, the Secretariat has also consulted with the customs administration.

#### **3.7.1 Applying reference prices at the Customs**

Some businesses commented on the application of reference prices in some customs offices, for goods imported both from EU and non-EU countries. These businesses claim that even when they had all the documentation justifying the transaction (including original invoices which can be easily verified by the Albanian customs administration through information exchange with the customs administrations of exporting countries), they were still obliged to pay VAT at the customs, with VAT being calculated on the computed value based on reference pricing lists, in line with alternative evaluation methods. According to these businesses, customs' failure to acknowledge the real price of the transaction/invoice and application of alternative methods increases chances of corruption, due to direct contacts of economic operators with customs officers, confusion, lack of stability and room for evasive interpretation. Viewed from a broader perspective, this makes it difficult for the business to ensure fiscal and financial compliance.

According to the customs administration at the beginning of this year it was established and made operational the National Valuation Database as per WCO<sup>28</sup> recommendations. National Valuation Database unifies customs valuations in different branches of customs and ensures equal treatment of all operators nationwide. Based on the current legislation regarding customs valuation of goods, the revaluation is done in cases where there is reasonable suspicion. Despite this, the customs administration is obliged to justify such interventions.

GCD clarifies that the use of the method of transaction has increased. Presently, the transaction method is used for about 88% of the declarations. Alternative methods are used mainly for goods originating outside the EU. The list of goods has been diminishing in number. For 2015, have been removed from the list 92 items while 83 items removed for 2016.

#### **3.7.2 Customs procedures/commodity codes**

Some entities (apparel industry) have been subject to fines on the justification that the commodity code in the customs declaration was incorrect, according to an assessment of the custom's laboratory, which businesses say to have not received. They add that even after filing an

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<sup>28</sup> World Customs Organisation

administrative appeal they have not been provided with the laboratory results and “the answer to the appeal was vague, indicating only legal references”. According to businesses, the code is assigned by the Customs Office of the other countries (e.g. Italy) and their change does not bear any financial consequences for the customs, because they are commodity codes for active processing regime goods, which are not, under any circumstances, subject to the customs’ code. For this reason, fines on these kind of cases are considered by the business as excessive.

In the meantime, GCD clarifies that laboratory response should be sent to the businesses. Specifically, based on the Directive 8909/1, dated 10.04.2014, article 6.2 /a, states explicitly that *"the laboratory sends 2 copies of Certificate to Customs Branch. Customs branches have the obligation to attach to the customs practice the "Certificate of Verification of the type of goods and Tariff Classification" issued by the Customs Laboratory. Customs branches send the other original certificate to the entity or its representative for information about the conclusions issued by the Customs Laboratory"*. Also, GCD informs that Ministry of Finance has proposed in the fiscal package for 2017, changes in the law on customs tariffs, where is proposed that for a significant list of products which are used by the apparel (cut-and-trim) industries, customs tariffs become 0% starting from January 1, 2017.

### **3.7.3 Non-release of customs guarantees and failure to timely communicate pertinent reasons to businesses**

Even though customs procedures have improved (as also confirmed by the Chambers of Commerce and Industry of Gjirokastra and Durrës), non-release of customs guarantees, set upon request of the customs administration, still remains a problem. It was reported during meetings (2-3 cases) that even though the 6-month deadline needed for the guarantee had expired and the customs administration had already controlled the cleared goods, *customs guarantees had not yet been released* even following constant requests from businesses. Moreover, there was no answer whatsoever to businesses’ requests. The said businesses understood this to result from the pertinent customs offices’ need to increase *“their revenues”*.

After verifying with GCD this concern of the business, GCD states that *"These cases relate to bank guarantees hold by custom branches when they accept the transaction as customs value till the verification of the invoice. There are cases when the reply from corresponding customs office is delayed more then 6 months (the legal deadline), then the customs cannot release the guarantee. This issue is not related to customs revenues, since the guarantees are seized in the bank and cannot be used by customs or business"*.

### **3.7.4 Informality and unfair competition**

Regardless of the positive impact of the measures that were applied during September – December 2015 against informality, these measures are currently becoming less persuasive. This has encouraged again a high degree of informality, identified mainly among small businesses that execute transactions with the final consumer and which have been selling products without using fiscal devices. So as not to exceed the VAT threshold (5 million) these businesses refuse to take invoiced goods from businesses that sell at retail prices. In the conditions when retail businesses

cannot legally sell with a fiscal invoice (fiscal device)<sup>29</sup>, but only through tax invoices, they end up reporting lower turnover and unfair competition from other entities that sell without an invoice by encouraging, thus, informality. This situation has brought about serious difficulties for honest businesses, distortion of the market and fair competition and, as a result, fewer revenues for the state budget from VAT or profit tax.

#### IV. RECOMMENDATIONS

According to the IMF study<sup>30</sup>, it is suggested that the best VAT refund practices should have the following characteristics:

- Adequate prediction and monitoring systems to anticipate the degree of VAT refund applications;
- The refund should take place within a reasonable legal timeframe (e.g. 30 days from the refund application) and be accordingly reported;
- The administration should pay interest on late refunds;
- The recoverable VAT amount should go for the payment of VAT and other tax liabilities.
- Exporters should be refunded immediately.
- The verification of VAT refund applications should be integrated in the broader tax control programs, where preliminary controls are limited only to high risk cases.
- Appropriate sanctions should be applied for taxpayers who claim fraudulent refunds.
- On reasonable grounds, taxpayers should have the right to appeal decisions of the tax administration that reject refunds.
- The tax administration should offer clear information to the taxpayers on the rights and obligations related to procedures that make a refund application valid.

Recommendations processed by the Secretariat as a remedy to the findings of the survey and discussions held with the groups of interest are as below:

##### **Recommendation 1 – Respect deadlines set forth in the applicable legal framework.**

Automatic VAT refund should continue to be executed within 30 days for taxable persons that export more than 70% and between 50%-70% of their total sales value, according to the risk

<sup>29</sup> Article 54/5 of Law No. 9920 dated 19.05.2008 "On tax procedures" (amended) stipulates that: "Until 31.3.2016, for any wholesale taxpayer who sells goods to buyers who do not exercise any commercial activities (individuals), the sales by invoice issued by the fiscal cash register shall not exceed 10% of the taxable amount of the goods sold on the same tax period of the previous year, VAT excluded. As of 1 April 2016, wholesale taxpayers shall not be allowed to sell with tax invoice to buyers who do not exercise any commercial activities (individuals)" (Amended by Law No. 99/2015, dated 23.09.2015. Published in the Official Journal No. 187, dated October 28, 2015).

<sup>30</sup> IMF Working Paper, VAT Refunds: A Review of Country Experience, Graham Harrison and Russell Krelove, November 2005

analysis, and within 60 days for all other taxpayers, again in accordance with the risk analysis. Conclusion of procedures within the ambitious deadlines set forth in the legal framework remains a challenge for the administration. Regardless of the fact that these deadlines can be somehow short, procedures should be carried out based on the following elements:

- Efficient risk analysis criteria, as in Recommendation No. 2.
- Constant periodic training for the tax administration.
- Obligatory interest on late VAT refunds for tax administration to businesses, in accordance with Article 76 of Law No. 9920.

### **Recommendation 2 – Ease the procedural burden for the tax administration and businesses.**

- Efficient application of the risk system to enable a reduction in practice of the number of controls, generally, of the tax administration (including controls on VAT refund). In this context cooperation and exchange of information should be strengthened between the GTD and the GCD regarding risk assessment on VAT refund, as part of plans to conduct joint analysis on risk in tax and customs offices<sup>31</sup>.
- Consideration of the risk elements in cases when the business has shifted within a certain period of time, for example, 1 year to full/thorough control to avoid the control on VAT refunds for tax periods included in this timeframe. This element should be acknowledged in internal guidelines for GTD inspectors.
- Proper application of VAT refund principles when the taxpayer meets the basic criteria, for example the amount of 400,000 ALL and for 3 consecutive months. Practices when the requested VAT amounts are acknowledged as recoverable to the businesses, but not refundable on the basis of unreasonable doubts or not grounded on the legal framework should be avoided.

Some of the businesses and experts contacted by the Secretariat go even farther in their suggestion to simplify the process through automatic VAT refund on monthly basis for every recoverable VAT amount. They are of the opinion that the risk of abusive practices can be fully avoided in this case through the conduct of thorough controls in accordance with the criteria of the risk system, real-time exchange of information between institutions, such as for example between tax and customs administrations, tax and NBC etc. From the Secretariat's viewpoint **such a reform should be seen as a long-term objective**, rather than as a realistic opportunity for short term implementation in the conditions when the administration and the businesses themselves are at very early stages of consolidating their activity to guarantee compatibility with the applicable legislation.

### **Recommendation 3 – Transparency over internal procedures in addressing VAT refund cases.**

It is suggested that an internal document on the tax administration is drafted and published – *Rules of procedure for the VAT refund*, detailing the fundamental principles and risk criteria, concrete

<sup>31</sup> IMF Country Report No. 16/143, Albania June 2016

steps, procedures and deadlines that various levels within the tax administration, including the Risk Department, Control Department and VAT Refund Department should bear in mind regarding this procedure. The document will enable the professional enhancement of inspectors, especially at the local level, but will also standardise the process from central to local level. The publication of these Rules of Procedure is recommended as an expression of high standards of a transparent, accountable administration with a view on taxpayers.

**Recommendation 4 – Improve information offered by GTD through an interactive website (including a helpdesk or hub) for businesses, to enable the fiscal education of taxpayers and increased transparency, but above all, to facilitate a more structured service.**

From the Secretariat's point-of-view and as businesses underlined, this information is indispensable, but remains basic and does not offer guidance for businesses' specific needs. It is necessary that information reaches taxpayers in a more structured way, be it via the official webpage or through online training sessions, at set times, for certain business categories. For example, it is difficult for the average taxpayer to surf the current webpage, even when searching for the most recent legislative amendments (2015-2016).

**Recommendation 5 – Budget plans should not determine the tax administration's decision-making for refund delays on recoverable VAT.**

This recommendation was presented during the Focus Group meeting of the Secretariat with experts of the area on 07.11.2016. It was admitted that the tax administration is conditioned in respecting VAT refund procedures, among other things, from the need to respect the plan of revenues generated from tax, as projected by the Ministry of Finance. **According to the experts, the refundable VAT line must not be the responsibility of the tax administration, but must be planned as a separate budget line.**

In this way the tax administration would avoid "conflict of interest" in accomplishing its revenue plan on one hand and respecting deadlines for the refund of the recoverable VAT.

**Recommendation 6 – The reform launched in 2015, should be structured, efforts for the enforcement of anti-informality measures should be improved**

As the IC recommended during meeting No. 3 *"Informality as a common Government – Business challenge"* every measure in the context of the formalization reform must take place in partnership with honest businesses. Constant application of measures against businesses which carry out their economic activities without issuing tax invoices must be of priority. The application of such measures should not only be punitive, but educational at the same time, for all taxpayers, and should finally aim to provide proper conditions for fair competition.

**Recommendation 7 - Businesses need to further build "their capacities" in terms of receiving timely and accurate information regarding any changes that affect the environment they operate in.**

The analysis of the Secretariat and meetings with all stakeholders found that, in order to provide this service to the business, it is indispensable for business associations to perhaps engage "dedicated people," by putting at their disposal timely and accurate information that would enable a more structured discussion and consultation process about changes affecting the businesses.

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