

## SUGGESTIONS<sup>1</sup>

### INFORMALITY A COMMON GOVERNMENT-BUSINESSES CHALLENGE

*4<sup>th</sup> December 2015*

As of 1 September 2015, the Government officially initiated an extensive campaign against informality in the country. This action was preceded by public statements during the period July-August 2015, regarding the necessity to fully establish the rule of law in the economic and commercial activity sphere in the country. The start of this campaign was also preceded by a series of concrete steps undertaken by the Government, starting with the establishment of a working group within the Council of Ministers, discussions with the Inter-Ministerial Strategic Planning Committee (SPC) and the presentation of the campaign to the National Economic Council (NEC), but yet not published.

The process was accompanied by a big number of field tax inspections (fiscal visits), with the aim of scanning the situation of informality, numerous statements given on the media by all stakeholders, followed by a series of legal initiatives. A "unique" intensity of the debate and reaction may be noticed with regards to this campaign, involving the Government, the business and its representative associations, as well as international institutions. This is due to the fact that informality is a multi-dimensional phenomenon carrying within itself both risks and benefits for the country.

This Paper aims to analyse the phenomenon, guide the debate on the necessity to formalize the economy with a view to providing some practical recommendations in tackling informality by business perspective. Moreover, it takes into consideration both the Government<sup>2</sup> attempts and the statements made by the business, while supported by a thorough analysis prepared by the Secretariat.

For the purpose of this paper, a number of studies prepared by OECD, IMF, the World Bank, IFC, EBRD, including Government and national public sources are simultaneously consulted. Tailored interviews are made with various business and public actors, including a focused consultation with representatives of fourteen (14) Chambers of Commerce and business associations<sup>3</sup>. In addition, an anonymous survey on informality was prepared by the Secretariat and launched online in the website of the IC for the purpose of obtaining the direct opinion of the business. The survey was filled in online by 89 enterprises and by 11 others during the face-to-face meetings with the Secretariat experts. In order to respect the sectorial and concrete dimension, the analysis was also accompanied by a study of informality in the milk processing sector.

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<sup>1</sup> This Report is a synthesis of the full Analytical Working Document prepared by Secretariat on the topic of Informality. The Working Document will be submitted in the Investment Council Meeting of 15<sup>th</sup> December and will be published on the official website of the Investment Council

<sup>2</sup> A track record of all Government actions since 2004, is documented in the full analytical report

<sup>3</sup> <https://www.investment.com.al/for-an-efficient-reform-against-informality/>

Informality in Albania mainly appears in the form of unregistered businesses, tax evasion and informal employment. The figures published by the government relating to the success of its campaign, constitute a clear indicator on the dimension of informality in the country. The measures undertaken are still a subject of debate by experts, business associations and other stakeholders regarding their efficiency and proportionality in relation to the ultimate goal this campaign is expected to reach. Meanwhile, the main discourse is focused on the approach and the means used, in time and space, the sector specificities and the size of businesses, incentives, penalties and involvement of the private sector.

There is a common convergence of views among business actors, that support Government's attempts regarding this venture although it maybe *“painful to some population groups, but still necessary to the benefit of the country's economy”*. They suggest that the tackling informality must be viewed in the context of a genuine Reform, a Strategy against Informality, with more incentives and less punishing, based upon clear legal provisions.

Our analysis is focused on five major pillars:

- I. Formalization reform where the business is a partner
- II. A responsive tax system and a tax administration to formalisation.
- III. A regulatory system supporting formalization.
- IV. Access to credit and financial services, as incentives to formalization.
- V. Consultation, transparency and education of taxpayers.

## **I. FORMALIZATION REFORM – IN PARTNERSHIP WITH BUSINESS**

World experience<sup>4</sup> has shown that the approach to formalization implies a structure of reforms extended in time, considering legal and institutional dimensions (including but not limited to the tax and customs administration), the provision of incentives and the gradual toughening of penalties, the protection of vulnerable groups and certain sectors that tend to be informal. Tough rules shall apply once good, simple and sustainable laws and regulations have been adopted.

There is a broad consensus by various actors on the “need to formalize” and the benefits this process will bring to fair competition, attraction of serious investments and the economic growth in the long term. On the other hand, there are uncertainties and incomplete information as to:

- a) the further steps and extension in time of the action undertaken;
- b) the priorities, expectations and the thoroughness of the action against informality.

Although the Government has mentioned the preparation of a two-year plan of measures to be undertaken, such a plan has not been discussed with the business actors, nor has it been published yet. Additionally, it is not clear for the business community, if there is in place or under discussion any draft strategy against informality.

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<sup>4</sup> Turkey, Georgia, Moldova, Macedonia and the EU countries, Italy, Slovakia, etc.

### ***Recommendation 1:***

We suggest the elaboration by the Council of Ministers of a *Comprehensive Strategy* against informal economy on the basis of sectorial analyses (including Roadmap of Actions).

The document should be accompanied by an action plan built upon sectorial approaches, with well-defined time frames and responsible institutions, in advance consulted and coordinated with the business representatives. The document should be published and the preparation process should be transparent and all-inclusive. The formalization could be gradual and based on a platform with clear rules for the business. This is due to the fact that different sectors have different fiscal and social specificities which impact on the level of informality, for example, the energy sector or the banking sector are more formal and regulated compared with the agribusiness or trade, where a higher degree of informality is easily observed.

## **II. A TAX SYSTEM RESPONSIVE TO FORMALISATION**

According to the World Bank data<sup>5</sup>, Albania has the lowest contribution in the collection of public revenues in relation to GDP in the region, while the tax burden is at the highest level, and procedures to be correct to taxation are more complicated compared to the region after Serbia<sup>6</sup>. Additionally, the Secretariat Survey on Informality indicates that the procedures, the number of taxes and the tax burden remain the most problematic issues in doing business in the country. There is strong reaction from the business and the tax experts, who consider fragmentation of the tax system<sup>7</sup> as an impetus to informality, against the limited capacities of tax administration, unresponsive to the intensity and professionalism the formalisation reform requires. Although significant steps have been recently undertaken by the General Directorate of Taxation, such as the implementation of the risk module or carrying out intensive trainings, we believe there is still lot to be done to upgrade the tax administration-business relationship. Establishment of a climate of better mutual understanding and partnership during the inspection process is essential by aiming a more consultative approach (for instance, the first inspection of tax officials to the business to be consultative, and then the in case of failure to respect the instructions given by the tax auditors, the second inspection could initiate the application of penalties). This would avoid confusion, misinterpretation and abuse by both parties. According to the direct answers in the Survey, corruption and political influences (about 25% of responses) in the state administration may encourage informality and failure to comply with tax system.

### ***Recommendation 2:***

Reassessment and analysis of the current tax system (the burden and the politics) whether it discourages or encourages formalization on the basis of the following elements:

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<sup>5</sup> World Bank Data

<sup>6</sup> Paying Taxes 2016

<sup>7</sup> Please refer to the survey "On Tax Inspection", of the Secretariat of 5<sup>th</sup> October 2015

### ***a) The discourse on the VAT /Profit Tax threshold***

Some tax experts and many undertakings recommend the reassessment with a tendency to decrease the VAT threshold, in order not to cut off its chain, while others do not see the VAT threshold as a problem, but rather emphasize the improvement of the tax administration. The Profit Tax threshold, for purposes of its gradual application depending on whether being a large/small enterprise, should guarantee a fair treatment of taxpayers and avoid creating room for tax evasion. Meanwhile, the attention must be focused on simplifying the procedures for payments in tax and customs offices, the usage level and efficiency of tax register machines (in tourism, agriculture, etc.), the analysis and registration of losses or even the income tax, applicable depending on the professions. Escalation of penalties or even fines, and the perception of corruption associated with them, call for a deeper analysis, including the respective costs and benefits.

### ***b) Incentives that may accompany the battle against informality***

- Tax relief for new enterprises, the ones that reinvest the profit up to a certain amount, enterprises that employ a specific number of employees, or those enterprises carrying out their activity in underdeveloped areas.
- Assessment on the reference prices efficiency at the customs, whether they constitute cause for smuggling and tax evasion. Removal of reference pricing is identified by enterprises as a potential incentive, for example by importers of tiles, construction materials, clothing, etc.
- Clear incentives for the consumers to take the tax receipt by enabling direct benefits from the declaration of annual income.
- The subsidy scheme in agriculture is not sufficiently stimulating to achieve formalization, as it only covers a limited category of farmers. We suggest strengthening the current scheme regarding their incentives through the VAT refund. With regards to the wine sector, due to the high number of licences and permits needed, or the medicinal plant and milk processing sectors, the situation appears more complicated and requires a more thorough analysis.

## ***Recommendation 3***

Simplification of administrative bureaucracy with the aim of reducing the number and time for carrying out payments in particular for medium, small and micro businesses, and making available to the taxpayers innovative services such as online tax payment, etc. Viewed from the perspective that 90% of enterprises are micro, and the level of awareness and financial know-how among enterprises is very low<sup>8</sup>, such measures would facilitate the tax compliance of this category.

## ***Recommendation 4***

Enhancement of administration accountability in order to respond to the formalization reform through:

- a) investment transparency and accelerating the modernisation of information technology such as the well-functioning of the new tax system and risk system, which must precede the field actions, thus increasing the public confidence.

<sup>8</sup> <http://www.monitor.al/shqipëria-e-parafundit-në-botë-për-njohuri-financiare/>

- b) specialized training sessions for the employees, especially those of the tax and customs administration<sup>9</sup>.
- c) fast and effective appeal and advisory structures, and the preparation of manuals and commentaries for inspectors and enterprises regarding their reciprocal rights and duties.

### III. A REGULATORY SYSTEM SUPPORTING FORMALIZATION

A number of concerns are evidenced on the numerous and uncoordinated inspections, on the unclear functioning of the market regulatory institutions (whether local or central), difficulties in registering farmers, the number of licences for a production activity, failure to control or segmentation of the domestic production chain, etc. Apparently, one of the most problematic sectors regarding to the informality, which involves also a significant social dimension, is the agro-industry. The study case of the milk processing analysed may be considered also as a representative of the development of other sub-sectors of agro-industry. Herein, has resulted that many companies are not yet equipped with technological cards, there is still significant uncertainty regarding the farmer registration, confusion between the NUIS (Unique Identification Number) and the farmer's card, etc.

#### ***Recommendation 5***

The formalization reform must also have a goal to relieve the administrative burden for taxpayers, by promoting compliance with the tax system and the regulatory system as well as a higher standard of the final goods and services in the following aspects:

- a) The online coordination of State Inspectors and online exchange of information (data matching) on Inspections as well as on the registration of private entities, such as the NRC with the Employment Office and other Inspectorates (e.g. NFA, the Environment Inspectorate, etc.).
- b) Unification of investigation and inspection units of the Tax Administration and Custom Administration in order to enable an effective control and detection of cases of tax avoidance, but also exchange of information and expertise.
- c) Recognition of the Technological Card for certain operations, especially in agro-business and coordination with the Tax Administration for the acknowledgement of the respective losses from the technological process.
- d) Clear legal definition of wholesale and retail markets, in order to prevent switching from a certain status to another. Clear definition of the street-trader. Redefinition of the functions of inspection to such businesses by central and local institutions.
- e) Enabling the connection between the NUIS of the farmer to the electronic land registry and electronic animals' registry, etc.

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<sup>9</sup> Please refer to the Recommendations of the Investment Council in meeting No. 2 <https://www.investment.com.al/sq/events/mbledhja-nr-2-5-tetor-2015-1600-2/>

- f) Formalization in agriculture must be preceded by the completion of the land registration, formalization of the land market, registration of the farms and livestock and improvement of official statistics.
- g) Enhancement of the coordinating capacities and functions of responsible institutions subordinate (at central and local level) to the Ministry of Agriculture, Rural Development and Water Administration, in charge of imposing and monitoring the quality on value added approach in agro-industry.

#### **IV. ACCESS TO FINANCING AND IMPROVEMENT OF FINANCIAL SERVICES - AN INCENTIVE IN FORMALIZATION**

Access to financing remains one of the key incentives that must accompany formalization of enterprises and enable the provision of cheaper financing sources. At the same time, the assessment on possible reducing of bank transaction commissions, increase of bank transactions will reduce the cash flow in economy and thus lead to less informality. Our analysis and especially the online Survey finds that 49% of businesses (starting from ALL 2 million turnover) consider access to financing as very difficult and costly, thus negatively impacting the business and investment climate. This situation has affected an increase of the informal funding outside the banking system, through unreliable and informal schemes, for example usury. However, the plan of measures undertaken by the Government and the Bank of Albania on reducing NPL, upon the support of IMF are to be appraised, including the efforts to finalize the new Bill "On Bankruptcy in the Republic of Albania" prepared with the support of IFC. Such measures are believed to relieve the banking sector, and positively impact the increase of crediting in the private sector.

##### ***Recommendation 6***

- a) Further cooperation with banking financial institutions and the non-bank financial institutions should be considered in the context of the formalization strategy and its expected benefits. In this context the micro-credit institutions may play an important role in the reduction of informal economy, especially in rural areas.
- b) To be assessed the threshold and the categories of farmers reimbursed through banking system. The recent changes, regarding channelling payments to farmers by the collectors through the banking system require a deeper analyses who shall pass through the banking system. It should consider that rural population has very limited access to the banking system and such services entail considerable costs.
- c) Encouraging banking transactions and electronic payments such as through PoS, especially in trade and services. Implementation by the tax administration of the existing legal provisions, which do not pose the obligation to use the tax registration machines when the taxpayer does not collect any *cash*, shall help small enterprises by reducing costs. For this purpose, the Ministry of Finance and the General Directorate of Taxation must unify their interpretations regarding such cases.



## V. PRIOR CONSULTATION, TRANSPARENCY AND INCLUSION

With reference to the comments made in the Survey, and the analysis, it is evident that business is still unclear on the further steps of the campaign against informality. They remain still sceptical on the “so far” results. Although the law on public notification and consultation is in place, the absence of prior consultation on legal initiatives and reforms with the public and other stakeholders is highlighted. Specifically, there was a clear stand by the business associations on the “lack” of prior consultation regarding the latest amendments to the Law on Tax Procedures and the 2016 Tax Package.

During the period September-November, a series of forums were organised with the business on the campaign, whereby the Government mostly reported and informed on the measures decided to be implemented and its progress, rather than obtain the prior constructive opinions of the businesses regarding the measures against informality.

Frequent legal amendments<sup>10</sup>, the lack of clarity of the bylaws (e.g. the latest amendments to the Instruction No. 24, dated 02/09/2008 "On Tax Procedures"), the absence of prior consultation and consultation, hinder the full contribution of the private sector to formalization.

### ***Recommendation 7***

- Implementation of the Law No. 146/2014 “On Public Notification and Consultation” regulating the process of public and prior notification and consultation of bills, draft national and local strategic documents, and policies with a significant public interest.

### ***Recommendation 8***

- Grant and crediting programmes by the Government and Donors may play a key role in awareness raising and consultation on the formalization of certain public sector groups, such as to support the Government's action during the first 2-3 years.
- It is suggested to increase the consultation and awareness-raising to the farmers. To be considered the establishment of an intermediate unit for the provision of assistance and information to farmers regarding the registration and the benefits of formalization, upon the assistance of the donors and the Government.

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<sup>10</sup> Law No. 9920, dated 19/05/2008 has been amended 12 times altogether.