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Republic of Kosovo

Public Sector Revenues

Tax Policies, Tax Evasion and Tax Gaps

June 2014



Poverty Reduction and Economic Management Unit
Europe and Central Asia Region



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FISCAL YEAR

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WEIGHTS AND MEASURES

Metric System

ACRONYMS AND ABBREVIATIONS

ATM	Automatic Teller Machine	LTU	Large Taxpayer Unit
CIT	Corporate Income tax	MoF	Ministry of Finance
EBRD	European Bank for Reconstruction and Development	NACE	Nomenclature générale des Activités économiques dans les Communautés européennes
EU	European Union	NGO	Non-Governmental Organization
FDI	Foreign Direct Investments	NPISH	Non-Profit Institutions Serving Households
FYR	Former Yugoslav Republic	OECD	Organization for Economic Development and Cooperation
GDP	Gross Domestic Product	PIT	Personal Income Tax
GFCF	Gross Fixed Capital Formation	PoTI	Perceptions of Tax Implementation
GoK	Government of Kosovo	SEE	South East Europe
GPS	Global Positioning System	SIDA	Swedish International Development Cooperation Agency
HBS	Household Budget Survey	SME	Small and Medium Enterprises
IC	Intermediate Consumption	STU	Supply and Use Table
IMF	International Monetary Fund	TAK	Tax Administration of Kosovo
IT	Information Technology	UNMIK	United Nations Interim Administration Mission in Kosovo
KPST	Kosovo Pensions Savings Trust	USAID	United States Agency for International Development
LiTS	Life in Transition Survey	VAT	Value Added Tax
LLC	Limited Liability Company		

Vice President:	Laura Tuck, ECAVP
Country Director:	Ellen Goldstein, ECCU4
Acting Sector Director:	Roumeen Islam, ECSPE
Sector Manager:	Satu Kahkonen, ECSPE
Task Team Leaders:	Agim Demukaj, ECSPE
	Simon Davies, ECSPE

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This report has been prepared by a World Bank team working in Kosovo during 2013. The principal authors were Sandeep Bhattacharya (Professor, Duke University and Consultant); Jiashan Cui (Consultant); Simon Davies (Economist); Agim Demukuj (Country Economist); and Munawer Khwaja (Lead Public Sector Specialist). The team benefited from the extensive participation of Julia Dhimitri (Public Finance Specialist, Consultant); Gregory Kisunko (Senior Public Sector Specialist) and Andrea Sitarova (Public Sector Specialist). The team is also grateful for assistance from Deborah Hardoon (previously of Transparency International). The team is grateful for guidance from Satu Kahkonen (World Bank Sector Manager); Jan-Peter Olters (World Bank Country Manager for Kosovo); Abebe Adugna (Lead Economist); Ellen Goldstein (World Bank Country Director); and Roumeen Islam (World Bank Sector Director). Mismake Galatis type-set the report and Kim Murrell helped to edit it.

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EXECUTIVE SUMMARY

Kosovo has a simple tax system and relatively low tax rates. Value Added Tax (VAT) and Corporate Income Tax (CIT) rates are flat at 16 percent and 10 percent respectively and Personal Income Tax (PIT) is progressive at 0, 4, 8 and 10 percent for income brackets of €0-80, €81-250, €251-450 and over €450 per month. The tax legislation in Kosovo with respect to PIT, VAT and CIT are broadly aligned with international and European Union (EU) standards.

A risky feature of Kosovo's tax system is the high dependence on "border taxes". In 2012, 71 percent of revenue was collected at the border in the form of trade taxes and VAT on imports. The current structure of Kosovo's economy explains the current tax base profile. Over the recent past, imports have been worth between 52 and 57 percent of GDP.

Shifting from border to domestic revenue collection is needed. The solution for the excessive reliance on indirect taxes and border revenues partially lies in bolstering domestic production and reducing Kosovo's excessive reliance on imports. But strengthening the Tax Administration of Kosovo (TAK) and improving the tax policy framework by broadening the tax base, is also required. A gradual shift to revenues from direct taxes – personal income tax, corporate income tax, social insurance, and property tax – and from domestically generated VAT and excise, are necessary for sustainable fiscal development.

The simple tax system could make it easier for the TAK to adjust direct taxes to achieve these aims while encouraging labor market formality. Income below the minimum wage should be exempt from tax, both to provide greater equity and to draw people out of shadow employment. At the same time, the introduction of health insurance could help to broaden the tax base and, if well-implemented, encourage tax compliance. Municipal level taxes can stimulate accountability, fiscal sustainability and efficient public services. Property taxes have several advantages over other taxes and are a potential source of domestic revenue. They are also likely to be below their optimal rate, and are currently below neighboring country rates.

Low domestic revenue collection suggests the presence of a large "tax gap" – the difference between the amount the TAK should collect and the amount it actually does collect. Undertaking a tax gap analysis is challenging in an environment with limited or questionable data, such as Kosovo. Nonetheless, a tax gap analysis was conducted. It focused on estimating the tax base for VAT, PIT and CIT using, as far as possible, a "bottom up" approach based on micro-level data. From these estimates, the tax potential is calculated and compared with actual tax revenues to provide measures of the tax gap for each tax. In addition, the analysis looks specifically at revenues from tobacco and alcohol.

The study revealed that there is a significant tax gap: a VAT gap of about 34 percent was attributed largely to low VAT collection from domestic suppliers; a PIT gap is about three times what is collected now; and a CIT gap estimated at about 17 percent of current collections. In addition, the estimated size of the underground economy during 2004-2011 is estimated at between 7.5 and 18.8 percent, and partly explains the tax gap as well as reinforcing the need to bring a greater proportion of the economy into the formal sector to broaden tax revenues.

A recent World Bank survey¹ supports the findings from the tax gap analysis, revealing that there exists a perception among firms that many of their competitors evade taxes and that corrupt practices may be partly to blame for this. While not a surprising finding, given that Kosovo ranked alongside Ethiopia and Tanzania in Transparency International's 2013 Corruptions Perceptions Index, it does however, have large costs to the tax system. Respondents believed that around half of firms evade some of the legally-owed VAT and CIT. Many firms also reported that their competitors under-report the number of people they employ or their staff's wages to reduce the amount of PIT they need to pay. Firms believed that political connections were key to escaping penalties for tax evasion. Tax evasion from the formal sector alone is estimated at 5 percent of domestically collected VAT and CIT revenues, and 12 percent of PIT revenues.

The wider social and economic consequences of tax evasion are high. For the private sector, the implications are large: (i) firms focus on ways to evade taxes and escape penalties rather than ways to increase productivity, harming economic development; (ii) tax evasion by some firms creates an uneven playing field with firms with better connections, rather than those that are most productive, benefiting more; (iii) tax evasion by some firms reduces tax collections, which has to be made up by higher taxes for firms that are tax-compliant and tax compliant firms may become more reluctant to pay taxes if they perceive that their competitors are avoiding taxes. Ultimately, perceptions are capable of reversing the culture which accepts taxes as a "moral" imperative.

Furthermore, perceptions - whether they are correct or not - can influence reality by changing social norms. This is especially important in light of research that suggests that (perceived) social norms affect tax compliance (Torgler, 2003; Cullis et al., 2012). For example, individuals or firms may be under less pressure to pay taxes if they believe others are not doing so, either because there is less social pressure to do so or because they perceive a lower risk of being caught. Firms that believe that competitors are not tax compliant may also choose to avoid paying taxes to ensure that they can compete on a level playing field. There is a real risk that such perceptions could create a vicious circle of non-compliance.

The results presented in this survey are meant to be indicative rather than conclusive. Although firms reported perceptions - which bring both strengths and weaknesses - many questions were of a sensitive nature and some therefore had high non-response rates. On average, firms skipped 14 percent of questions, with refusal rates ranging from zero to 63 percent of questions of a sensitive nature. Firms with female owners and older firms tended to skip more questions than others. The likelihood of bias, if any, that resulted from refusals, was evaluated by type of firm. All detailed results are provided in the appendices to this report.

¹ Perceptions of Tax Implementation (PoTI) Survey, was conducted by World Bank in June 2013 and is discussed in detail in Chapter 2. The PoTI survey was undertaken because despite the many positive attributes of the tax regime, there were indications that many firms perceived corruption and tax evasion to be widespread, with the two often linked. The survey aimed to shed some light on the extent of these beliefs and to make a preliminary estimation of the costs of tax evasion, if the perceptions reflect reality. The survey therefore questioned 100 randomly selected firms from the Large Taxpayers Unit (LTU) and an additional 81 randomly selected medium-sized (MS) firms about their views on their competitors' tax paying behavior. The sample size for medium-sized firms was small but nearly a quarter of firms in the LTU participated in the survey. Chapter 2 provides results for the full sample and notes any differences between medium and large firms.

Ultimately, finding ways to raise domestic revenue to compensate for the decline in border revenues is going to require actions on a number of fronts. In particular, efforts will need to be made to both broaden and increase the tax base. Several steps can be taken to help achieve these aims. First, strengthening the TAK's capacity to increase compliance and reduce tax evasion, including through judicial means, would help. Efforts to reduce complicity in tax evasion – effectively corruption – will also help. Second, reducing the informal economy would bring more firms and employees into the tax net. For example, small changes to the PIT system (e.g. increasing the tax threshold to at least the minimum wage) may help. Third, efforts can be made to increase revenues through existing taxes. For example, there may be room to increase revenues from property taxes and increased CIT. Finally, policies that boost private sector growth, including an improved business climate, will help to increase domestic production and therefore tax revenues. It may also encourage firms into the formal sector, further increasing domestic tax revenues.

CHAPTER 1. TAX AND REVENUE POLICY²

A. KEY MESSAGES

- **Kosovo has a simple tax system and relatively low tax rates.** Value Added Tax (VAT) and Corporate Income Tax (CIT) rates are flat at 16 percent and 10 percent respectively and Personal Income Tax (PIT) is progressive at 0, 4, 8 and 10 percent for income brackets of €0-80, €81-250, €251-450 and over €450 per month. The simple tax system could make it easier for the Tax Administration of Kosovo (TAK) to adjust direct taxes to encourage labor market formality while increasing equity and collections. The tax legislation in Kosovo with respect to PIT, VAT and CIT are broadly aligned with international and European Union (EU) standards.
- **A risky feature of Kosovo's tax system is the high dependence on "border taxes".** In 2012, 71 percent of revenue was collected at the border in the form of trade taxes and VAT on imports. The current structure of Kosovo's economy explains the current tax base profile. Over the recent past, imports have been worth between 52 and 57 percent of GDP. A combination of import substitution, lower prices of fuel and construction materials³ and slowing domestic demand in 2013 resulted in 8.8 percent lower than planned tax collection at the border, and 1 percent decline year on year for the first time during the last decade.
- **Shifting from border to domestic revenue collection is needed.** The solution for the excessive reliance on indirect taxes and border revenues partly lies in bolstering domestic production and reducing its excessive reliance on imports. But strengthening the TAK and improving the tax policy framework by broadening the tax base, is also required. A gradual shift to revenues from direct taxes – personal income tax, corporate income tax, social insurance, and property tax – and from domestically generated VAT and excise, are necessary for sustainable fiscal development. Preliminary estimations suggest that improved compliance and an expanded domestic production base would likely need to be the main source of new revenues, with increased collections from domestic VAT, PIT, CIT and excises making positive contributions of 0.5, 0.5, 0.4 and 0.3 percent of GDP between 2012 and 2018. A smaller positive contribution – estimated at 0.2 percent – can also be made from property tax.
- **Low domestic revenue collection suggests the presence of a large tax gap in Kosovo, which has been estimated at about 35 percent of actual collections.** Undertaking a tax gap analysis is challenging in an environment with limited or questionable data, such as Kosovo. Nonetheless, a tax gap analysis was conducted and it revealed that there is a significant tax gap: a VAT gap of about 34 percent was attributed largely to low VAT collection from domestic suppliers; a PIT gap is about three times what is collected now;

² Chapter prepared by Munawer Khwaja and Sandeep Bhattacharya. This chapter is reproduced from the Kosovo Public Finance Review: Fiscal Policies for a Young Nation, World Bank, 2014.

³ Fuel and construction materials present a large share of overall imports and any price changes for these commodities is reflected in total border revenues.

and a CIT gap estimated at about 17 percent. A tax evasion perceptions survey⁴ conducted by the World Bank in 2013 also supports these findings. These results should be treated with caution due to data quality – particularly for PIT – but the results nonetheless indicate the presence of a large tax gap that could be narrowed through enhanced enforcement.

- **A recent World Bank survey⁵ revealed a perception among firms that many of their competitors evade taxes.** While not a surprising finding, given that Kosovo ranked alongside Ethiopia and Tanzania in Transparency International's 2013 Corruptions Perceptions Index, it does however, have large costs to the tax system. Tax evasion is estimated at 5 percent of domestically collected VAT and CIT revenues, and 12 percent of PIT revenues. A high degree of evasion risks creating a downward spiral of non-compliance as firms evade taxes to ensure a level playing field with their competitors, whom they perceive as evading taxes.
- **Direct taxes collected at the center and municipal-level taxes are potential domestic revenue sources.** Income taxes (CIT and PIT) account for about 2.5 percent of GDP, which is the lowest in the region. Kosovo follows good practice with progressive PIT rates which provide vertical equity – individuals with low incomes pay lower tax rates on their income – though there is scope to adjust them to both increase equity and encourage labor market formality. Income below the minimum wage should be exempt from tax, both to provide greater equity and to draw people out of shadow employment. At the same time, the introduction of health insurance could help to broaden the tax base and, if well-implemented, encourage tax compliance. Kosovo could consider increasing the CIT rate to 15 percent. Municipal level taxes can stimulate accountability, fiscal sustainability and efficient public services. Property taxes have several advantages over other taxes and are a potential source of domestic revenue. They are also likely to be below their optimal rate, and are currently below neighboring country rates.

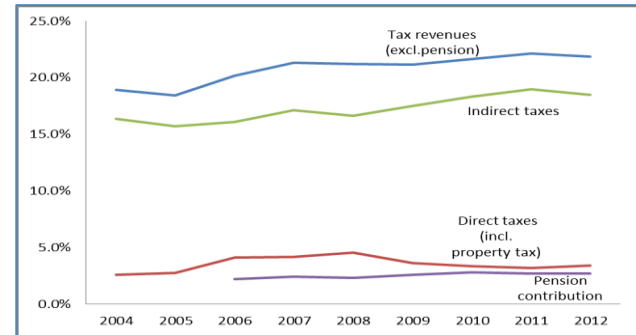
⁴ Perceptions of Tax Implementation (PoTI) Survey, was conducted by World Bank in June 2013 and is discussed in detail in Chapter 2.

⁵ The same survey as the above.

B. TAX POLICY IS JUDICIOUS BUT THERE ARE RISKS AHEAD

1.1 The right revenue mix is critical to enhancing economic growth, alleviating poverty and ensuring sustainable revenue streams to finance much-needed public investment. Since Kosovo adopted the euro as its official currency, it has had no control over monetary policy. Tax policy and budget therefore are the only instruments available to the Government of Kosovo (GoK) for achieving sustainable economic growth and macroeconomic stability. With large investment needs (due to run down physical infrastructure), a fiscally sustainable flow of revenues is necessary for Kosovo to build and maintain its physical infrastructure and address its key challenges. As such, the tax system needs to: (i) raise sufficient revenues to fund public spending that enhances growth and reduces poverty in a sustainable way without over-burdening taxpayers; and (ii) achieve the right balance between equity and maximizing economic incentives to work and invest. In this chapter Kosovo's tax policy framework and revenue administration performance is appraised with a view to identifying policy options that would encourage additional revenues to cover spending needs in a sustainable way.

Figure 1.1. Trends in Tax Revenues and Pension Contribution, % GDP



Source: World Bank staff estimates.

1.2 Kosovo achieved early successes in fiscal policy. Tax policy and administration reforms together with the introduction of new taxes and collection methods, contributed to a five-fold⁶ increase in domestic revenues between 2000 and 2004. The United Nations Interim Administration Mission in Kosovo (UNMIK) introduced a customs administration in September 1999, when it established border controls to collect taxes on all goods imported into Kosovo. Soon thereafter a tax administration was created.

1.3 The reforms helped Kosovo maintain low deficits and increase revenue collections, though they remain lower than other South East European (SEE) countries. As a result of the reforms, Kosovo managed to maintain fiscal deficit below 3 percent in the last 7 years. Tax revenues grew from 18.4 percent of GDP to 21.9 percent of GDP in 2012; revenues growth was 18 percent in 2011 and 5 percent in 2012 (Figure 1.1). Pension contributions for the Kosovo Pensions Savings Trust (KPST) (a defined contributions mandatory second pillar) collected by the tax administration grew from 2.2 percent of GDP to 2.7 percent of GDP during the same period. Despite the growth in tax revenues, Kosovo has one of the lowest overall tax-to-GDP ratios in the SEE region.

C. STRUCTURE OF PUBLIC REVENUES IN KOSOVO – A HIGH DEPENDENCY ON BORDER TAXES

1.4 A potential risk in Kosovo's tax system is the high dependence on tax revenue from imports (71 percent) compared with the rather low figure of only 29 percent from domestic

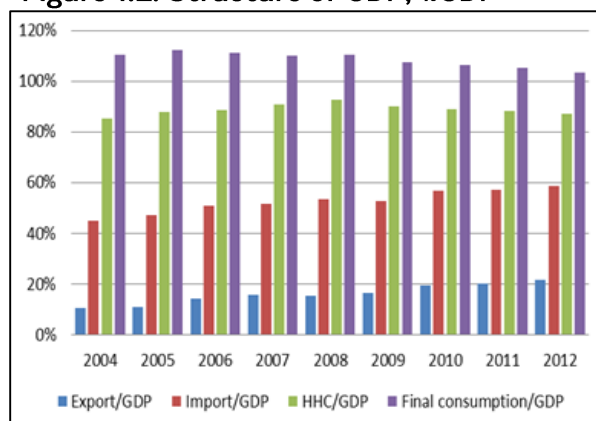
⁶ This great result is also because revenue collection started from very low levels in 2000. TAK was established only in second half of 1999 after the 1998-99 war in Kosovo.

revenue. Although this is an improvement from 2004 when only 23 percent was collected domestically, this is clearly not a viable long term situation. The country cannot rely so heavily on import revenues and will need to build strong domestic revenue resources that are fiscally sustainable.

1.5 The current structure of the economy impacts the way taxes are collected. Household consumption averaged 89 percent of GDP over the last decade, most of which was imported (Figure 1.2). In 2012, imports accounted for 67 percent of household consumption, and import VAT receipts were 81 percent of total VAT revenue (Figure 1.3). In 2012 a significant part of household consumption and FDI was financed from remittances, (about 15 percent of GDP) and international aid (about 8 percent of GDP). The industrial sector is weak and most economic activities in the private sector – trade, retail, restaurants/bars and construction -are mainly small-scale, typically hard to tax, and many are not taxed.

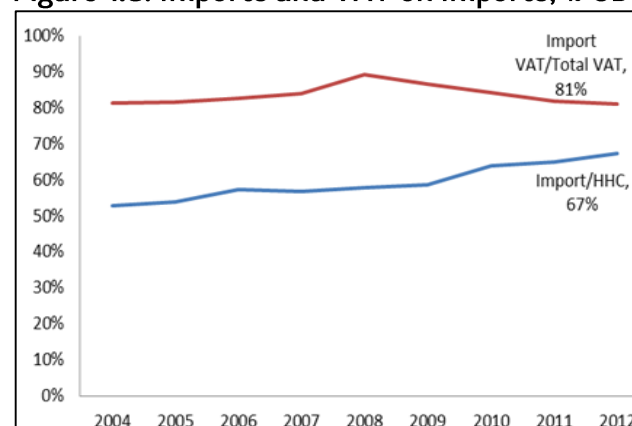
1.6 The problem of border revenues has become more visible in the last two years. Revenue collection did not achieve its 2012 target and worsened in 2013, mainly as a result of a shortfall from revenues collected at the border. A €30 million shortfall or 0.6 percent of GDP in 2012, widened in 2013 to €50 million, or 1 percent of GDP. In 2013, for the first time, border revenue collections were lower than in previous year. This weak result was driven by a combination of a price decrease in Kosovo's main import commodities, an import substitution effect (reducing taxes collected at the borders) and a decline in domestic demand for imports. Domestically collected VAT compensated 1.8 times the shortfall of border VAT. This is a very important development toward creating tax stability by compensating shortfalls of tax revenues collected at the border with more sustainable tax collected domestically, especially as imports decline.

Figure 1.2. Structure of GDP, %GDP



Source: Statistical Agency of Kosovo.

Figure 1.3. Imports and VAT on Imports, % GDP

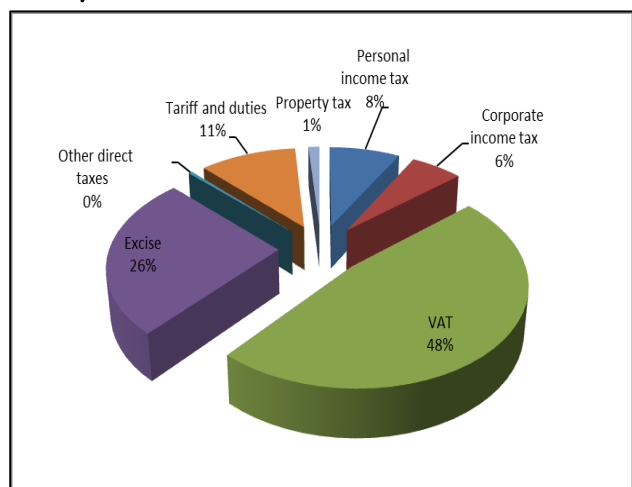


Source: World Bank staff estimates.

1.7 A narrow tax base and low labor participation are also partly responsible for the high dependence on consumption tax revenues. Only 15 percent of tax revenue comes from direct taxation (including 1 percent from property tax) while the rest mainly derives from taxes on consumption (VAT and excise) and customs duties (Figure 1.4 and Figure 1.5). In part the limited coverage of direct taxes is constrained by the narrow tax base, a very low labor

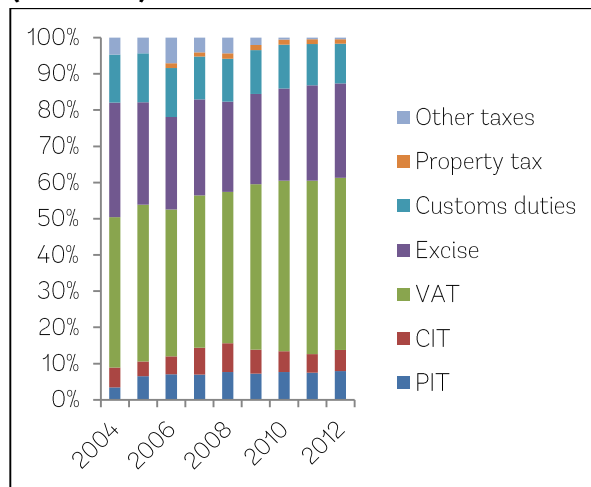
participation rate (37 percent) among the working age population⁷ and a high unemployment rate of 30.9 percent. In part this also reflects very low direct taxation rates: the highest rate of income tax is 10 percent; and in 2009 corporation tax was halved from 20 percent to 10 percent.

Figure 1.4. Structure of Taxes in 2012 (% of Total)



Source: Ministry of Finance.

Figure 1.5. Dynamics of Tax Structure (2004-12)



Source: World Bank staff estimates.

1.8 VAT more than doubled with a growth of 125 percent between 2004 and 2012. VAT revenues grew from 42 percent of total tax revenue in 2004-08 to 48 percent in 2012. Excise duties remained steady at 26 percent and customs tariffs and duties at 12 percent of total tax revenues between 2005 and 2012 (Figure 1.5). PIT also grew but remained around 7 percent of collections and corporate income tax at around 6 percent of total tax revenue over the same period. PIT generated only 1.7 percent of GDP during the period, which is about half of the SEE average of 3.5 percent of GDP.⁸ As a result of halving the corporate income tax (CIT) rate revenues fell from 1.7 percent of GDP in 2008 to 1.3 percent in 2012, which is lower than the average of 2.0 percent in SEE countries. Property tax provided only 1 percent of total tax revenue (or about 0.3 percent of GDP), compared to an average of about 0.6 percent of GDP for the SEE region, despite the post-conflict construction boom. Property tax rates remain exceedingly low by regional standards.

D. METHODOLOGIES APPLIED TO MEASURE INFORMAL SECTOR AND REVENUE POTENTIAL

1.9 Analysis of the informal sector and the revenue potential can be approached from different angles and can be calculated using different methodologies. From the tax policy perspective, what matters are the taxable base and the scope of exemptions, loopholes and tax holidays that narrow the tax base by creating revenue gaps that could have been collected under a more simple tax regime. One way to look at the revenue performance in a country is using the top-down approach where the productivity of different tax revenues is calculated. Productivity measures how much of the tax base is taxed and how much is left untaxed. In an ideal world,

⁷ This level of labor participation is substantially below the average among all transition economies (65 percent).

⁸ Grote, M, D. Benedek and Selcuk Caner. Kosovo: Reform Proposals Toward a More Balanced and Revenue Productive Tax System, November 2011, IMF, Washington, D.C.

productivity would be 100 percent if the entire base is taxed, there are no exemptions and there is no leakage due to tax evasion or collusion. Another method is the bottom-up approach of drilling into the bases of each of the main taxes to examine the potential tax base and the tax gap. Yet another measure is to estimate evasion based on currency demand to show the size of the underground economy. Unlike productivity, the last two methods demonstrate the gap from the perspective of leakage due to tax evasion or collusion rather than from the perspective of tax policy loopholes or exemptions.

Size of the Informal Economy

1.10 Low revenue collection from domestic sources suggests the presence of a large informal economy. Using the Vito Tanzi model based on currency demand, the overall size of the underground disposable income as a proportion of disclosed disposable income⁹ averaged 17 percent over the period 2004 to 2011 (see Chapter 3). The model takes into consideration currency in circulation, monetary base to liabilities ratio of the central bank, GDP, consumer price inflation, marginal lending rate, number of bank outlets (ATMs, branches), money velocity, disposable income, and currency/deposit ratio. The underground disposable income is likely to be an underestimate to the extent that the cash in circulation is underestimated with reference to measured GDP. With remittances estimated at 15 percent of GDP and a large errors and emissions line in the balance of payments, estimates of cash in circulation are likely to be on the low side.

Tax Productivity¹⁰

1.11 The productivity of VAT in Kosovo at 65 percent is close to the average for ECA countries. This means that in Kosovo, for every 1 percent of VAT tax rate, VAT collection captures 65 percent of the VAT tax base (which is consumption), leaving 35 percent of consumption untaxed. The untaxed base could be a result of exemptions for certain part of the VAT base, or because tax evasion and/or weaknesses in the tax administration prevent the full base to be taxed. The performance of VAT collection seems adequate since it is close to the average for Europe and Central Asia.

1.12 The productivity of revenues from income taxes is very low. For CIT the productivity is 14 percent, which means that only 14 percent of the CIT base is actually taxed. For PIT the situation is even worse. The productivity of PIT revenue is just 12 percent, meaning that only 12 percent of the PIT base is taxed. Clearly there is much scope for improvement in revenue performance in both PIT and CIT. This can be done by reducing tax loopholes and exemptions and strengthening the capacity of the tax administration to effectively fight tax evasion. Given that the tax system is already simple, with few loopholes (and should remain this way), the focus should be on the tax administration. It is clear from the productivity analysis that opportunities for improving the revenue performance are much greater for PIT and CIT than for VAT.

⁹ Disposable income without time adjustment.

¹⁰ Tax productivity is the actual tax collected as a percent of the tax base divided by the standard tax rate. For VAT, consumption is usually taken as the tax base since GDP excludes imports (which are subject to VAT) and GDP includes export (zero-rated under VAT) and investment (for which input credit is given under VAT). For income taxes, GDP is typically used as the tax base.

Tax Gap Analysis¹¹

1.13 The World Bank conducted a detailed tax gap analysis for VAT, PIT and CIT. Key findings are presented below and details of estimation methodology and the data used are presented in detail in Chapter 3. It is important to note that the results presented below should be seen as indicative due to both availability of data and the quality of some data. Two issues in particular stand out: income data in the Household Budget Survey (HBS) is not believed to be reliable as it totals around a quarter of consumption; and in absence of detailed firm-level data and random company tax audits, the study needed to simulate the range of the likely CIT gap based on non-random audits. These issues are discussed in detail in the companion paper, which also presents corroborating evidence from a separate firm survey of perceptions of tax implementation as well as other indicators. Despite the data issues, the results presented indicate the presence of a large amount of tax evasion.

1.14 The VAT gap is calculated to be about 34 percent. A tax gap analysis of the VAT gap was conducted using data from 2011 for household consumption with breakdown of expenditure and details of categories and exempt consumption. Similar calculations were made for the government and Non-Government Organizations (Non-Profit Institutions Serving Households, NPISH). Based on the analysis, the total VAT base, after taking into account exempt sectors, was estimated at €4.5 billion. This is close to 2011 GDP of €4.77 billion. At the rate of 16 percent the potential VAT revenue would be €719 million. In 2011, the Tax Administration of Kosovo (TAK) reported revenue of €121 million and the Customs Authority collected €415 million in VAT, a total of €536 million. This implies that the VAT gap is approximately 34 percent. This number is consistent with the figure for VAT productivity.

1.15 The PIT gap is estimated to be approximately three times what is collected now. Data for the PIT base was computed from a combination of the household budget survey (HBS) and the household consumption data in the absence of other sources.¹² The data on household income are perhaps the most problematic in the estimation of the tax gaps. For the PIT gap the following were included: (i) wage tax, (ii) SME tax, (iii) taxes on interest, dividend, rent and gambling, (iv) individual profit tax and (v) other taxes. In 2012, €91 million were collected from these taxes. It is estimated that only about one-third of the potential PIT revenue is collected. The tax potential is in the range of three times what is collected now, i.e., about €270 million and the tax gap would be about €180 million. There seems to be a large potential for collecting additional revenue from PIT, partly through increasing formality and partly by reducing tax evasion.

1.16 The CIT gap is estimated at about 17 percent but better data are needed to be more accurate. In the absence of detailed information the tax gap for CIT was computed based on audit detection. Data from audit detection show that the tax gap is very high for micro and small firms. In the baseline case, potential evasion is estimated at €10.6 million or 17 percent of the CIT receipt of €62.7 million for 2012. Further refinement of data – notably fully random audits to compare with risk-based audits – would be required to get a more accurate estimate.

¹¹ The tax gap analysis was done by the Bank team together with Sandeep Bhattacharya, Associate Professor at the Sanford School of Public Policy at Duke University.

¹² In Kosovo national accounts are not estimated on the income side.

Tax Evasion¹³

1.17 A recent World Bank survey revealed that firms perceive that a significant proportion of their competitors evade taxes. The Perceptions of Tax Implementation (PoTI) survey questioned nearly a quarter of firms in the Large Taxpayers' Unit (LTU) as well as some medium sized firms about their views on their competitors' tax paying behavior. The results are presented in detail in Chapter 2. If perceptions reflect reality, CIT and domestic VAT evasion from large, formal firms alone cost the government at least 5 percent of collections annually, and around 12 percent of PIT collections. These results imply that tax evasion is responsible for between 15 and 25 percent of the tax gap discussed above.

1.18 The wider social and economic consequences are even higher. For the private sector, the implications are large: (i) tax evasion may encourage firms to put effort into evading taxes and escaping penalties when caught rather than becoming more productive, harming economic development; and (ii) evasion by some firms creates an uneven playing field in the private sector with firms with better connections, rather than those that are most productive, more likely to be able to benefit; (iii) tax evasion by some firms reduces tax collection, which has to be compensated by higher taxes for firms that are tax compliant potentially encouraging tax compliant firms may become more reluctant to pay taxes if they perceive that their competitors are evading taxes; and (iv) if tax evasion is partly the result of corruption, firms may face unpredictable costs to doing business, which may discourage investment.

1.19 The survey revealed that political connections were considered helpful in escaping severe penalties for tax evasion. Around 31 percent of respondents believed that "at least one of the owners being a politician" is the single most helpful way to escape a severe penalty for tax evasion. Another 30 percent of respondents believed that having "an owner or top-level manager who has personal friends in TAK" was the single most helpful way to avoid a penalty. These results point to significant high-level collusion in tax evasion, which would require robust mechanisms of enforcement to counter and to avoid a downward spiral into non-compliance.

Revenue Potential

1.20 A recent study by Khwaja and Iyer¹⁴ shows that Kosovo's revenue potential (including social contributions) is 25.9 percent of GDP compared to 21.9 percent actually collected. The study uses a mix of structural variables, institutional variables and policy variables, using panel data from 61 countries, to analyze empirically the revenue potential. The results indicate that there is significant potential for improving the revenue performance by making the right policy choices. This could be used as an opportunity to correct the imbalance between revenues generated domestically and at the border. However, this result assumed that the informal sector can be brought into the tax net. Excluding the informal sector suggested that the existing small formal tax-base is already over-taxed. Therefore care should be taken not to

¹³ This section is based on: World Bank (2014). "How my competitors avoid paying their taxes: Perceptions of tax evasion among firms in Kosovo".

¹⁴ Khwaja, Munawer S. and Indira Iyer (2013) "Revenue Potential, Tax Space and Tax Gap in ECA Countries: A Comparative Analysis, World Bank, Working Paper (draft). See Appendix I for the results from this study modified to include Kosovo by using a shorter time period (for which Kosovo data are available).

further burden compliant taxpayers but to broaden the tax base or to replace existing taxes – such as those collected at the border – with new ones collected domestically.

E. A TAX POLICY REFORM FRAMEWORK FOR KOSOVO

1.21 Because Kosovo's heavy reliance on indirect taxes collected at the border risks long-term fiscal stability, the objective of this review is to identify features in the current tax structure that could be altered in ways that would help bring greater balance between direct taxes and indirect taxes and between revenues collected domestically and at the border. Indirect taxes are considered to be less elastic – less responsive to changes in economic growth – and more regressive than direct taxes. A good tax policy framework should reflect the compliance environment, the size of the shadow economy and the capacity of the tax administration using international best practice as appropriate to the country situation.

1.22 Given the weak tax administration, the shift from taxes collected at the border should be done in a gradual and phased manner to optimize stability. The mix of tax policy measures should include: (i) augmenting revenues from personal income tax and corporate income tax; (ii) enhancing the collection from property tax; (iii) strengthening domestic VAT and excise collection through better compliance management; (iv) rationalizing SME tax regimes; and (v) improving tax administration.

Augmenting Revenues from Corporate and Personal Income Taxes

1.23 Income taxes (CIT and PIT) account for about 2.5 percent of GDP which is the lowest in the region (Table 1.1). The combined productivity of CIT and PIT in Kosovo is also among the lowest in SEE. In Kosovo, CIT was originally applied at the rate of 20 percent on the accounting profit after adjustment for tax purpose. This was reduced to 10 percent from January 2009. The reduction in the CIT rate led to a drop in revenue from 1.7 percent of GDP to 1.4 percent of GDP. Between 2009 and 2012 it has averaged 1.3 percent of GDP. Albania, Bosnia and Herzegovina, Bulgaria, Kosovo, FYR Macedonia, Montenegro and Serbia all had CIT and PIT rates of 10 percent or less in 2011. The financial crisis forced some countries to increase tax rates. In 2012, Serbia raised CIT rate from 10 percent to 15 percent while the PIT rate for income exceeding 6 times the annual average wage is now 15 percent. In 2013, Montenegro raised the PIT rate for income above €720 to 15 percent.

1.24 Kosovo follows the good practice of having progressive rates for PIT which provides vertical equity - individuals with low incomes pay lower rates of tax on their income. Other Eastern European countries that have progressive rates include Croatia, Moldova, Montenegro (from 2013), Serbia, Slovenia and Turkey. In Kosovo, PIT rates start with a rate of 0 percent for annual income below €960, followed by 4 percent for annual income above €960, and a marginal rate of 8 percent above annual income of €3,000. The top marginal rate is 10 percent for annual income above €5,400. However, the progressivity is thin because the difference between the top and the bottom marginal rates is small and the range of income brackets between €960 and €5,400 is narrow.¹⁵

¹⁵ The monthly minimum wage at the time of writing in Kosovo was €170 (for people aged over 35), which is an annual income of a little over €2,000.

1.25 There is potential for Kosovo to raise additional domestic revenue from PIT. The tax gap analysis discussed earlier showed that Kosovo's revenue potential from PIT is three times what it currently collected. Kosovo has one of the lowest PIT revenue productivity in the region (Table 1.1). FYR Macedonia, Bosnia and Herzegovina and Bulgaria collect about twice as much PIT revenues as a share of GDP with similar tax rates. This is a result of a combination of several effects: (i) exemption from PIT of several categories of income which narrows the tax base; (ii) weak tax administration; and (iii) large shadow employment that is not adequately captured. While serious efforts have been made by the Tax Administration of Kosovo (TAK) to improve performance much more need to be done.

Table 1.1. Regional Comparison of Income Taxes Performance (Excluding Presumptive Taxes) 2011

	Statutory CIT Rate	Top marginal PIT Rate	CIT Revenue % of GDP)	PIT Revenue (% of GDP)	CIT+PIT yield (% of GDP)	CIT Productivity	PIT Productivity
Kosovo	10%	10%	1.3	1.2	2.5	0.13	0.12
Macedonia	10%	10%	0.8	2.1	2.9	0.08	0.21
Moldova	12%	18%	0.7	2.2	2.9	0.06	0.31
Bosnia Herzegovina	10%	10%	0.8	2.3	3.1	0.08	0.23
Tajikistan	25%	13%	1.4	1.9	3.3	0.06	0.15
Albania	10%	10%	1.5	2.1	3.6	0.15	0.21
Bulgaria	10%	10%	1.9	2.9	4.8	0.19	0.29
Armenia	20%	25%	2.6	2.2	4.8	0.13	0.09
Montenegro	9%	9%	2.0	3.3	5.3	0.22	0.37
Turkey	20%	35%	1.9	3.6	5.5	0.1	0.10
Azerbaijan	20%	30%	4.3	1.4	5.7	0.22	0.05
Serbia	15%	15%	1.2	4.7	5.8	0.12	0.31
Croatia	20%	40%	2.4	3.5	5.9	0.12	0.09
Kyrgyz Republic	10%	10%	4.2	2.0	6.2	0.42	0.20
Belarus	24%	12%	3.1	3.2	6.3	0.13	0.27
Russian Federation	20%	35%	4.2	3.7	7.9	0.21	0.28
Georgia	15%	20%	2.8	5.9	8.7	0.19	0.30
Ukraine	25%	17%	4.1	4.7	8.8	0.16	0.31
Kazakhstan	20%	10%	8.2	1.4	9.6	0.41	0.14

Source: Tax at a Glance in ECA Countries, World Bank, 2013.

1.26 Policy makers should consider reorganizing the rate structure for PIT to make it more equitable and encourage formality in the labor market, and removing some of the exemptions that have no place in a good tax system. The income brackets range from half the minimum wage to 2.5 times the minimum wage which minimizes vertical equity. Income below the minimum wage should be exempt from tax, both to provide greater equity and to draw

people out of shadow employment. Also the income brackets should be broadened and the rates should be raised for higher income brackets. A recent IMF report¹⁶ illustrated a simulation of a more equitable rate structure using 2010 data, with rates of 10 percent, 15 percent and 20 percent for income brackets of €2,000 to 4,500, €4,500 to 8,000 and over €8,000 respectively. According to the report this would increase PIT revenue by €20 to 22 million, an increase of 42 percent, raising PIT as a ratio of GDP from 1.1 percent to 1.6 percent.

1.27 Care should be taken when amending tax brackets to ensure that it does indeed encourage formality and does not over-burden the small group of existing formal taxpayers. If it done correctly, a reform such as this would lower the burden for low income tax payers and collect more revenue from high income taxpayers. One option would be to expand social insurance to introduce a widely-demanded health insurance scheme (see Health Chapter 2014 World Bank Public Finance Review of Kosovo). According to data from the KPST, there were 225,000 employees and 30,684 self-employed who contributed to the second pillar pension in 2012. Since the second pillar is collected by the TAK, these numbers also reflect the approximate number of PIT taxpayers.¹⁷ This is a mere 15 percent of the total population. There is obviously a large shadow sector, some of which could be reduced if the tax burden for the lower levels of wage earners is lowered. Likewise, the policymakers should consider removing the following tax exemptions which may have been useful during post-war reconstruction but have outlived their utility: (i) dividends owned by foreign shareholders; (ii) interest on financial instruments issued by public authorities; and (iii) fringe benefits provided by employers.

1.28 An inclusive health insurance scheme would be one way to increase direct revenues and broaden the tax base. With one of Europe's most under-funded healthcare systems as a share of GDP that is defined by a lack of access and significant catastrophic spending for the poor, the introduction of a health insurance scheme appears to be popular. Such a scheme could help to address these issues, posed by the chronic under-funding of the sector, while replacing falling border revenues with internally-generated ones. In addition, the scheme could be more inclusive than just the formal sector by collecting premiums from all citizens who are not exempt (e.g. the poor). This would help to expand the revenue base. Care would, of course, need to be taken to minimize negative impacts on the labor market, to protect the poorest groups from payments (see Social Protection Chapter of the Kosovo Public Finance Review), and to ensure that health insurance does not increase the overall fiscal deficit nor place additional spending burdens on other ministries. In addition, systems would need to be in place to ensure that payments could be made easily by those who are not formally employed, for example through the commercial banking system. However, if a health insurance scheme were seen to deliver value-for-money, it could increase demand for the service, thereby making a positive contribution toward tax compliance. The benefits of a well-functioning system could therefore potentially be large making positive contributions to state revenues (partly offsetting the decline in border revenues), increasing tax compliance, and broadening the tax base.

1.29 The rationale given for reducing the corporate rate from 20 percent to 10 percent is questionable. The logic has been to make Kosovo a favored destination for attracting foreign

¹⁶ Grote, Martin, D. Benedek and S. Caner. "Kosovo: Reform Proposals Toward a More Balanced and revenue-productive Tax System". IMF, Washington, November 2011.

¹⁷ This number has gradually grown from 165,000 employees and 18,675 self-employed in 2004.

investments, reduce informality and corruption. As far as attracting foreign investment is concerned, it is a misplaced notion that reduced CIT rate will attract investment. First, if all countries in the immediate neighborhood reduce their rates, as was the case in SEE, then the effect of the reduced rate is neutralized and investment inflow would depend on the business environment and available physical and social infrastructure (healthy and skilled manpower). Second, a reduction in the rate in the host country (e.g., Kosovo) does not benefit the investing foreign company, since it pays tax on its global income in the home country (usually a developed country) and gets a deduction of the tax paid in the host country, to avoid double taxation. The smaller the tax rate in the host country, the smaller the deduction and the larger the share of the tax paid in the home country of the foreign country. Thus, in effect, by having a low CIT rate, Kosovo is transferring the benefit of its scarce revenue to the treasury of the developed home country, not to the investor. Nonetheless, halving the CIT rate from 20 to 10 percent in 2009 did reduce tax revenue but by less than 20 percent, suggesting that it was partly successful in encouraging payment and formality, although there were many confounding factors. Kosovo could consider raising its CIT rate to 15 percent to cover some of the tax gap mentioned earlier, but would have to ensure that compliance was maintained evenly across firms to reap the full benefits.

Enhancing Collection of Property Tax

1.30 Taxation at the subnational level is a key revenue source which can stimulate accountability, fiscal sustainability and efficient public services. Kosovo has a fairly well-designed system of budgetary grants which unfortunately leaves little incentives for municipalities to raise own-source revenue, resulting in exceptionally low municipal tax rates. The minimum rate on property tax collected by municipalities should be raised and central government grants should reward own-source generation of revenues. This would require careful dialogue and revision of the grants system. In addition, property taxes can be difficult politically and so would have to be managed in a way that is perceived to be fair.

1.31 Property taxes have several advantages over other taxes and are a potential source of internal revenue. Property taxes tend to be easier to collect than other forms of taxation and are relatively less distortive. They are difficult to evade (property is visible); are less likely to affect behavior than taxes on income; and taxes on land cannot distort supply since this is fixed. Because of these benefits, property taxes are more conducive to economic growth than other taxes, especially in emerging economies (OECD, 2010). In addition, revenues tend to be more stable than most sources of tax (Norregaard, 2013). Several countries (notably Ireland and Portugal), facing recent revenue shortfalls from more mobile or volatile sources, chose to ramp up their property tax collections. Despite the potential benefits of property taxes, Kosovo has not, so far, made property taxes a priority.

1.32 Collections from property taxes are likely below their potential. Kosovo raised around 0.3 percent of GDP from property taxes in 2011. This compared with an average of 0.4 percent for middle income countries and was significantly below the 0.9 percent average achieved the top-five middle income performers (Norregaard, 2013). Among SEE countries, both Montenegro and Serbia out-perform Kosovo with collections of 0.4 and 0.7 percent of GDP, respectively. One of the reasons may be Kosovo's comparatively low property tax rates and/or narrow tax base.

The other reason could be a large proportion of non-collection of what is already billed property tax.¹⁸

1.33 Kosovo's property tax rates are lower than some of their neighbors. Property taxes in Kosovo are charged at an annual rate of between 0.05 and 1 percent of the value of the property with reductions for main residences (Table 1.2). Rates are higher in Montenegro (0.1 to 1 percent of the property value), Serbia (0.4 to 2 percent), and Albania (1 to 3 percent outside of Tirana). Rates are lower in FYR Macedonia (0.1 to 0.2 percent of the property value) and Bosnia and Herzegovina's Republika Srpska (0.05 to 0.5 percent). As in Kosovo, all countries offer potential reductions based on factors such as occupancy. Property taxes are levied by local authorities in Serbia, Albania, FYR Macedonia and Bosnia as well as in Kosovo.

Table 1.2. Property Tax Rates in SEE (% Property Value)

	Minimum	Maximum
Albania*	1.00	3.00
Bosnia and Herzegovina**	0.05	0.50
Macedonia	0.10	0.20
Kosovo	0.05	1.00
Montenegro	0.10	1.00
Serbia	0.40	2.00

Source: Deloitte Tax Highlights, 2013.

Notes: *Outside of Tirana (Tirana applies rates of between 2 and 4 percent);

**Republika Srpska only.

1.34 Recognizing that improvements could be made, Kosovo has increased its property tax collection capacities. Considerable efforts have been made to improve cadaster through increased focus on registration and greater use of land titles. This has resulted in a doubling in the number of properties registered to around 80,000 in 2012. Similar efforts were made to construct a land registry (with nearly 2.3 million lots). The Property Tax Department of the Ministry of Finance (MoF) has upgraded its Information Technology (IT) systems so that all properties and lots can be identified with GPS coordinates and photographs. The Department is now developing a system to categorize properties based on use, size and quality as well as environmental efficiency.

1.35 These efforts are expected to boost property tax revenues for municipal authorities. The expanded cadaster registry will help to broaden the tax base and raise additional revenues. The land registry alone is estimated by the MoF to raise around €2 million per year for municipal authorities. In total, the MoF expects that property taxes will increase from around 35 percent of municipal revenues to around 50 percent, once the full impact of the improvements is felt.

Strengthening Domestic VAT and Excise Collection

1.36 The basic VAT structure in Kosovo is sound and designed according to EU norms. Although the VAT productivity is among the highest in the SEE region, much of the efficiency is gained from the fact that more than three-quarters of it is collected at the border where controls are easier and evasion less likely. While imports as a percent of household consumption is 67 percent, import VAT as a percent of total VAT collected is 81 percent. This shows that a significant part of domestic consumption remains untaxed under VAT. The low level of VAT collected from domestic suppliers indicates that there is significant tax evasion. Some of this is

¹⁸ Data suggest that during a local election year the collection of property tax is weakest. Anecdotal evidence suggests that local governments are not making enough efforts to collect taxes during those years to avoid/reduce tax pressure to potential voters.

the result of the weaknesses in the tax administration to combat evasion of domestic VAT revenue. The VAT registration threshold of €50,000 is among the highest in SEE. Businesses below the threshold are subject to a presumptive tax. While the high threshold reduces compliance cost for taxpayers and administrative costs for the TAK, it also risks many large and medium sized businesses to abuse the system by hiding as small businesses. Designing an SME tax regime that reduces the risk of abuse and encourages SMEs to graduate to the normal VAT regime would help erosion of the tax base from domestic value added.

1.37 Kosovo collects about 5.7 percent of GDP in excises which is among the highest in the region. However, almost all of it is collected at the border with domestic excise collections being miniscule. The current level of excise does not require much modification. The excise system has specific rates which is appropriate for Kosovo.

Improving Tax Administration

1.38 Created in the year 2000 under the auspice of UNMIK, and arguably the youngest in Europe, the Tax Administration of Kosovo (TAK) has had a reasonably successful short history. TAK has full operational autonomy within the Ministry of Finance. It administers personal income tax, corporate income tax, VAT, as well as performs the revenue collection functions for the second pillar pension fund on behalf of the Kosovo Pension Savings Trust. Kosovo Customs performs customs functions including collection of VAT on imports. Because it is new, it has been fortunate to avoid dealing with legacy systems and mindsets that exist in many other transition countries. As a result, over the last 13 years, TAK has taken significant steps to improve its capacity and service to taxpayers, thanks largely to support provided by international donors, primarily USAID, IMF, the World Bank and the European Commission. Kosovo ranks fairly high at 44th out of 186 countries on the Doing Business Paying Taxes Indicators. The productivity of VAT revenue at around 66 percent is close to the ECA average although the productivity of PIT and CIT revenues are still below the ECA average. The mandatory use of fiscal registers has helped improve VAT collection.

1.39 The TAK has developed an organizational structure that is function-based, and efforts to improve its capacities are evident. It has a relatively independent appeals unit which provides balanced dispute resolution in tax matters. As a result, eight decisions were decided in favor of taxpayers, 19 decisions were rejected. It has an internal audit department that examines the quality of tax functions and staff performance is in place. The IT department within TAK has upgraded continuously its capacities and recently developed and implemented e-filing, integrated system for business registration, an electronic taxpayer accounts system, and has a functioning call center. Training of personnel and public outreach of taxpayers is ongoing. Most of its inspectors, and almost all senior management, are highly educated and relatively well experienced. A strategic management department focuses on actions for future reforms and has developed the TAK Strategic Plan 2010-2015. Also annual compliance plans are produced in-house and greater ownership has produced better collection results. The efficiency of tax administration has been improving in terms of the cost of collections

1.40 A new IT solution, with assistance from the SIDA, has helped to complete a survey of all property in Kosovo and consolidate property data, taking in additional property characteristics. It is hoped that this will help improve property tax collection by municipalities.

1.41 Severe challenges remain: the large shadow economy and tax gap point towards serious weaknesses in the ability and willingness of the tax administration to deal with tax evasion and tax avoidance. TAK lacks the capacity to effectively monitor private sector activities. In 2010, a tax investigation unit was created within TAK to deal directly with tax crimes, which it is hoped will, in the medium term, help reduce the tax gap. The effectiveness and sustainability of TAK is severely impeded by the lack of professional, transparent and effective service to taxpayers. Although the situation has recently improved¹⁹ through public outreach, still there are taxpayers who do not understand their taxpaying obligations. According to Global Integrity 2011²⁰, tax laws are not always enforced uniformly and without discrimination, and corruption seems to be a major concern. Falling short on fair and uniform application and enforcement of tax laws to collect revenues is a critical impediment for establishing credibility and creating an atmosphere conducive to voluntary compliance. Arrears collection has been a significant problem but recently TAK has become more active in enforced collection actions including seizure of property and vehicles to the extent of € 500,000. The total amount of old arrears has consistently been falling.

1.42 Deficiencies in core areas of tax administration require greater focus on improving management effectiveness, staff training, and completing identification and registration of non-filers. The tax administration IT system, SIGTAS, needs to be upgraded to improve processing capacity, risk management and audit functions and enforced collection. Development of a reliable database and information matching system will be critical for reducing the number of non-filers and stop-filers.

F. RECOMMENDATIONS

1.43 A good tax policy framework should reflect the compliance environment, the size of the shadow economy and the capacity of the tax administration using international best practice as appropriate to the country situation. For sustainable fiscal development, there is need for a gradual shift from revenues collected at the border to revenue generated internally, both from direct taxes and domestically generated VAT and excise. Several steps can be taken to help achieve this within the existing tax structure:

- **Strengthening the tax administration.** This could include enhancing the quality and quantity of tax inspectors, improving risk assessment modules, including by adding the practice of random audits to assess areas for improvements in risk assessments.
- **Taking steps to fight tax evasion.** Analyses undertaken for this chapter and the PoTI survey suggest large tax evasion. Anecdotal evidence suggests that even in cases in which the TAK attempts to pursue evaders, they face obstacles in the judicial system. Efforts should be made to curb these illegal practices.

1.44 Changes could be made to the existing tax structure without making the tax system more complicated. These changes could also help to encourage formality,

¹⁹ The PoTI survey found that 90 percent of firms agreed that “all the information I need about tax compliance is easily available” and 84 percent agreed that “tax procedures are clear and simple”. Three quarters of firms agreed with the statement “tax legislation is sufficiently clear and precise to be easily understood by taxpayers and to avoid legal ambiguities in its application”.

²⁰ Global Integrity Report 2011, Washington, DC.

broaden the tax base and increase the perceived fairness of the tax system. Efforts could include:

- **Designing an SME tax regime that reduces the risk of abuse and encourages SMEs to graduate to the normal VAT regime.** This would help erosion of the tax base from domestic value added.
- **Considering raising the CIT rate to 15 percent while reinforcing enforcement.** The rationale given for the past reduction in the corporate rate from 20 percent to 10 percent is questionable. It did not produce any effects in attracting FDI as the same reduction of CIT happened elsewhere in the region. However, at the same time as increasing the rate, efforts should be made to strengthen enforcement of higher CIT. The halving of the CIT rate from 20 to 10 percent resulted in a decrease in tax revenues by just 20 percent suggesting that they may have been some benefits in terms of compliance. Any increase could have the opposite effect. Therefore, compliance capabilities would need to be ensured both to guarantee the maximum revenue benefits and to guarantee that all companies are equally burdened so as to avoid distortions in the private sector.
- **Considering streamlining the rate structure for PIT to make it more progressive and equitable, and remove some of the exemptions that have no place in a good tax system.** The following tax exemptions in particular, which may have been useful during post-war reconstruction, have outlived their utility: (i) dividends owned by foreign shareholders; (ii) interest on financial instruments issued by public authorities; and (iii) fringe benefits provided by employers.
- **Introducing a health insurance scheme that expands the tax base.** It appears to be demanded by a large proportion of the population and, if the scheme is well-implemented, could increase tax compliance.
- **Increasing efforts to expand collection of property tax.** The minimum rate on property tax collected by municipalities should be raised and central government grants should reward own-source generation of revenues. Also government should continue with its efforts to expand the property tax base by starting to tax agriculture land and other types of property.

CHAPTER 2. PERCEPTIONS OF TAX LAW IMPLEMENTATION²¹

A. KEY MESSAGES

- **In June 2013 the World Bank conducted a study of 181 medium and large firms representing all geographic areas and the main economic sectors in Kosovo.** The Perceptions of Tax Implementation (PoTI) survey was undertaken because despite the many positive attributes of the tax regime (see Chapter 1), there were indications that many firms perceived corruption and tax evasion to be widespread, with the two often linked. The survey aimed to shed some light on the extent of these beliefs and to make a preliminary estimation of the costs of tax evasion, if the perceptions reflect reality. The survey therefore questioned 100 randomly selected firms from the Large Taxpayers Unit (LTU)²² and an additional 81 randomly selected medium-sized (MS) firms about their views on their competitors' tax paying behavior. The sample size for medium-sized firms was small but nearly a quarter of firms in the LTU participated in the survey²³. This report provides results for the full sample and notes any differences between medium and large firms.
- **The results of the PoTI survey suggest that there is a widespread belief among firms in Kosovo that other firms evade taxes.** Respondents believed that around half of firms evade some of the legally-owed value-added tax (VAT) and corporate income tax (CIT). Many firms also reported that their competitors under-report the number of people they employ or their staff's wages to reduce the amount of personal income tax (PIT) they need to pay. Firms believed that political connections were key to escaping penalties for tax evasion.
- **The cost of this tax evasion is significant.** If perceptions reflect reality to some extent, then the VAT and CIT evasion cost the government around 5 percent of actual VAT and CIT collections each year and a minimum of 12 percent of PIT collections. These results imply that tax evasion is responsible for between 15 and 25 percent of the "tax gap" – the difference between the amount the Tax Authority of Kosovo (TAK) should collect and the amount it actually does collect – estimated in the Tax Gap Analysis presented in Chapter 3.
- **The wider social and economic consequences of tax evasion are even higher.** For the private sector, the implications are large: i) firms focus on ways to evade taxes and escape penalties rather than ways to increase productivity, harming economic development; ii) tax evasion by some firms creates an uneven playing field with firms with better connections, rather than those that are most productive, benefiting more; iii) tax evasion by some firms reduces tax collections, which has to be made up by higher taxes for firms that are tax-compliant and tax compliant firms may become more

²¹ Chapter prepared Jiashan Cui, Simon Davies and Agim Demukaj.

²² Inclusion in the LTU is based on VAT, PIT and CIT contributions but there is not an automatic threshold that determines inclusion. Once a company is in the LTU it remains there for a minimum of three years.

²³ There were 483 firms in the LTU in 2012.

reluctant to pay taxes if they perceive that their competitors are avoiding taxes. Ultimately, perceptions are capable of reversing the culture which accepts taxes as a “moral” imperative.

- **Perceptions are an imperfect measure of behavior but they do matter.** The PoTI survey did not measure reported firm behavior or experiences. Rather it measured firms’ perceptions of their competitors’ behavior. Since respondents had imperfect knowledge of their competitors, their responses do not necessarily reflect their actual behavior. Nonetheless, there are benefits to asking about perceptions. Perceptions tap into respondents’ knowledge and understanding of their sectors without asking directly about their own or another specific firm’s potentially illegal behavior. Those perceptions may also be based partly on their own practices but it is easier to discuss others’ behavior.
- **Furthermore, perceptions - whether they are correct or not - can influence reality by changing social norms.** This is especially important in light of research that suggests that (perceived) social norms affect tax compliance (Torgler, 2003; Cullis et al., 2012). For example, individuals or firms may be under less pressure to pay taxes if they believe others are not doing so, either because there is less social pressure to do so or because they perceive a lower risk of being caught. Firms that believe that competitors are not tax compliant may also choose to avoid paying taxes to ensure that they can compete on a level playing field. There is a real risk that such perceptions could create a vicious circle of non-compliance.
- **The results presented in this survey are meant to be indicative rather than conclusive.** Although firms reported perceptions – which bring both strengths and weaknesses – many questions were of a sensitive nature and some therefore had high non-response rates. On average, firms skipped 14 percent of questions, with refusal rates ranging from zero to 63 percent of questions of a sensitive nature. Firms with female owners and older firms tended to skip more questions than others. The likelihood of bias, if any, that resulted from refusals, was evaluated by type of firm. All detailed results are provided in the appendices to this report.

B. TAX AND CORRUPTION IN KOSOVO

2.1. **Kosovo has got many things right in tax.** Its tax system is simple and its people and firms enjoy a comparatively low compliance cost when preparing and paying their taxes. According to the World Bank *Doing Business* survey, Kosovars get their taxes done more quickly than any of their neighbors except Macedonians²⁴. The PoTI survey found that a large majority of firms found that tax procedures are clear and simple.

2.2. **Most people would be willing to pay more taxes providing the extra money is put to good use.** The 2011 *Life in Transition Survey (LiTS)* conducted by the World Bank and the

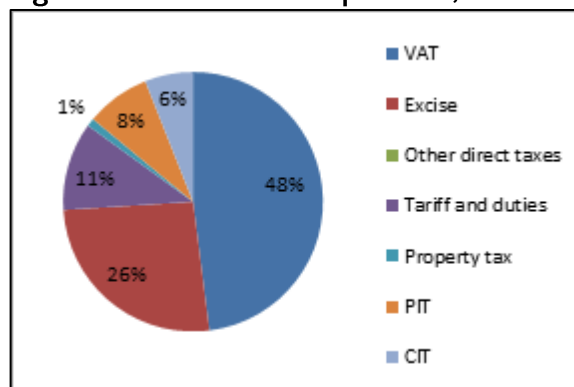
²⁴ World Bank, 2013.

EBRD²⁵ found that 85 percent of Kosovars would pay more taxes to improve their underfunded health system and 78 percent would pay more to improve education. Even in Macedonia – the second most accepting of taxation country in the Western Balkans according to the survey – only 68 percent of people would be prepared to pay more taxes to improve health and 60 percent would pay more to improve education. In Albania, these numbers were 36 and 41 percent, respectively. In Kosovo, 88 percent of people told the LiTS that paying cash to avoid taxes is wrong or seriously wrong – more than in any neighboring country. The PoTI survey found that over 95 percent of firms agreed with the statement that “all firms should pay taxes”.

Box 2.1. Tax Administration In Kosovo

The Tax Administration of Kosovo (TAK) administers the collection of taxes within the country and the Customs Agency administers collections at the border and the domestic excise. Total revenue was worth around 28 percent of GDP in 2012. Of this, VAT was the single largest contributor (Figure 2.1) with 48 percent of the total collections (about 11 percent of GDP). Corporate and personal income taxes contributed 6 and 8 percent respectively, though these are likely to become increasingly important as Kosovo develops. The TAK administers internal taxes²⁶ and social security contributions (second pillar pensions contributions worth 1.2 percent of GDP). They maintain a specific unit that supports large taxpayers, determined on the basis of contributions of VAT, CIT and PIT over previous years. The Customs Agency oversees collections of taxes collected at the border (trade taxes and VAT on imported goods) and domestic excise. Between them, revenues collected at the border were worth around 60 percent of total revenue in 2012.

Figure 2.1. Revenue Composition, 2012



Source: Authors' estimates using PoTI Survey.

The tax structure in Kosovo is simple and there are few loopholes that permit tax avoidance. The customs, CIT and top rate of PIT are all aligned at 10 percent. Some imports are subject to a zero rate of customs and income below €5,401 annually is progressively taxed at 0, 4 and 8 percent. There is a social security contribution – in effect an obligatory second pillar pension scheme – of 10 percent, of which half is paid by the employer and half by the employee. Dividends, interest and royalties are also payable through a 10 percent withholding tax. The standard VAT rate is 16 percent and there are few exemptions. Exports are not subject to VAT.

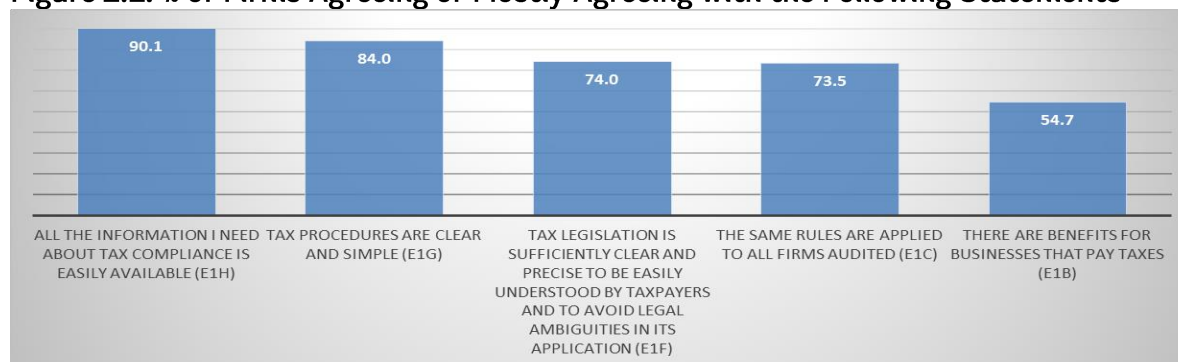
Most taxpayers are happy with the tax administration. The PoTI survey found that 90 percent of firms agreed that “all the information I need about tax compliance is easily available” and 84 percent agreed that “tax procedures are clear and simple” (Figure 2.2). Three quarters of firms agreed with the statement “tax legislation is sufficiently clear and precise to be easily understood by taxpayers and to avoid legal ambiguities in its application”. These results suggest that the TAK has largely been successful in communicating tax rules and providing information to make it easy for taxpayers to pay their taxes, though there is some room for improvement. Results from the PoTI survey also indicate that improvements could be made in being perceived to be fair since only around three quarters of firms agreed

²⁵ European Bank for Reconstruction and Development, 2012.

²⁶ Except domestic excise which is administered by Customs and property tax which is administered by Municipal Administrations.

that “the same rules are applied to all firms audited”. Being perceived to be fair and making it easy for taxpayers to pay are key elements in maintaining “tax morale”. This is especially important as only around half of firms agreed that there are “benefits for businesses that pay taxes”. Without obvious benefits to paying taxes, the TAK must rely partly on high tax morale whereby firms (and individuals) pay taxes not because they receive benefits but because they perceive paying taxes as a moral duty or part of a social contract.

Figure 2.2. % of Firms Agreeing or Mostly Agreeing with the Following Statements



Source: Authors' estimates using PoTI Survey.

2.3. Despite the positive news, there is a wide-held belief that there are serious governance issues in state institutions in Kosovo. The governance challenges facing Kosovo are reflected in the country's performance in international indicators. At 111th out of 177 countries, Transparency International ranked Kosovo alongside Ethiopia and Tanzania in their 2013 Corruption Perceptions Index²⁷. In the region, only Albania performed worse. Gallup's *Balkan Monitor* found that over 90 percent of Kosovars believed corruption to be widespread in government in 2012, worse than any other country in the region. The 2012 World Bank's *World Governance Indicators* rated Kosovo as the worst in the region for rule of law and in the bottom three for control of corruption²⁸. *Freedom House* rated Kosovo last among their eastern European peers in 2012 for judicial framework and independence, and only Moldova performed worse in their corruption indicator²⁹.

2.4. There is evidence that this corruption affects firms in Kosovo. A recent United Nations report on the impact of bribery and other crime on private enterprise compared the pattern and extent of bribery by businesses across countries in the Western Balkans³⁰. In spite of the geographical proximity and similar economic structure (micro business, with fewer than 10 employees, is the predominant form of business in the region), the report showed great variance in the prevalence and extent of bribery across countries. The survey targeted small and medium sized firms making the sample composition different from the PoTI survey. In Kosovo, 2000 firms participated in the survey. Bribery in Kosovo tended to be less prevalent but involved larger payments than in other countries. Kosovo had the lowest prevalence rate of bribery rate in the region (3.2 percent of firms in Kosovo reported paying bribes, the region average was 10.2 percent while Serbia ranked as the highest at 17 percent). Most bribes in Kosovo were paid in

²⁷ Transparency International, 2013.

²⁸ Kaufmann et al., 2013.

²⁹ Freedom House, 2012.

³⁰ United Nations Office on Drugs and Crime, 2013, “Business, corruption and crime in the western Balkans: The impact of bribery and other crime on private enterprise”.

cash (about 60 percent). On average Kosovars paid more than those in any other country per cash bribe (€1,787 or 38 percent of GDP/capita PPP), almost six times the amount in Bosnia and Herzegovina (€327) and double the regional average (€881). The report argued that this pattern implies that “bribes are less a part of day-to-day life in Kosovo than elsewhere but are paid in larger amount when the stakes are high for both bribe-payers and bribe-takers”.

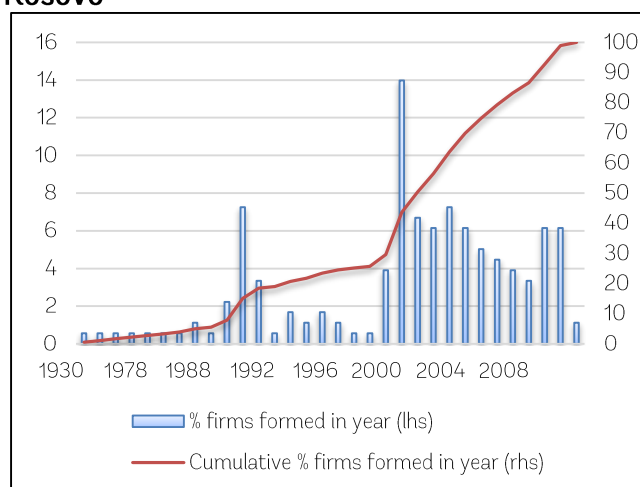
2.5. **There is evidence to suggest that the tax system is not immune from these governance issues.** Some tax evasion results from firms attempting to evade taxes – something that could be reduced by strengthening compliance controls. However, some tax evasion is perceived to enjoy collusion from public authorities. If the perceptions reflect reality to some extent, then poor governance also makes it difficult to realize tax collection potential.

Box 2.2. Firm Characteristics in the Poti Survey

Of the 181 firms that participated in the survey, 55 percent (100) were registered in the Large Taxpayers Unit (LTU). The remainder was comprised of randomly selected medium-sized firms. Over half of the firms in the sample (57 percent) operated mainly or were headquartered in Prishtina³¹. About 12 percent were in Ferizaj and 9 percent in Peja. About 18 percent of firms reported to have at least one female owner. More than half the firms were sole proprietorships (58 percent) and about 27 percent of the firms were limited liability companies (LLCs). Approximately 60 percent of firms were in service sector and 40 percent in the manufacturing sector. 17 percent of firms operated mainly in construction industry in either service or manufacturing. The majority of firms in the sample began operation in Kosovo after 1999 (70 percent) and fewer than 8 percent of the firms in the sample already existed in Kosovo before 1990 (Figure 2.3). The large number of firms established in 1990 and 2000 make sense given the historical³² context of the country. More than one third of firms in the sample exported goods or services and two thirds of the firms imported goods or services. This corresponds well with the broader economy; imports totaled 57 percent of GDP in 2011 while exports were worth 20 percent.

Firms in the manufacturing sector were more involved in international trade: about 79 percent of them in the sample imported goods or services (compared with 58 percent for firms in service sector), and 54 percent of them exported goods and services (compared with 26 percent in service sector). Construction firms were more likely to import service/goods (80 percent for construction firms versus 63.6 percent among non-construction firms). Construction firms also tended to be more recently established: about 76 percent of construction firms in the sample started to operate in Kosovo after 2000 compared with 69 percent of non-construction firms. This sampling makes sense given the recent growth of the public and

Figure 2.3. Year Firms Began Operation in Kosovo



Source: Authors' estimates using PoTI Survey.

³¹ Prishtina is the capital city and the main economic zone in Kosovo.

³² In 1990 former SFRJ became a market economy and many private firms were therefore created then. In addition many new firms were created in 2000, after the Kosovo war.

private construction sectors. These differences remain statistically significant after controlling for other observable characteristics of firms in the sample (see Table 4 in Appendix IV for detailed regression results).

Female owned firms in this survey were more likely to be in the LTU (20 percent of LTU firms had a female owner compared with 16 percent of MS firms). They were more likely to import and export goods and services: 76 percent of firms with female owners imported some goods/service and 42 percent of them exported goods/service, compared with 64 and 35 percent, respectively for other firms. Only 9 percent of firms with female ownership operated in construction sector while about 18 percent of firms without any female owner were in construction sector.

Respondents that have a good knowledge of their firm and sector were selected for the survey. A third of the respondents were accountants/finance managers in their firm and over 60 percent of the respondents received high school or higher education. About 9 percent of the interviewees were female. This matches the labor market characteristics of Kosovo, where fewer than 11 percent of working aged females were employed in 2012 compared with 40 percent of males (Kosovo Agency of Statistics, 2013). Two thirds of the respondents in the sample were over 35 years old.

In all analyses, firm and respondent characteristics were controlled. The full survey is presented in Appendix II.

C. THE COST OF TAX EVASION

Value Added Tax

2.6. Most firms believed that some Value Added Tax (VAT) is being evaded. Over half of respondents believed that at least some of their competitors under-declare revenues to the tax office to evade VAT (Figure 2.4)³³. Of these, around two thirds estimated that less than a quarter of their competitors evade some VAT while 9 percent believed that over half of their competitors practice evasion. Just 20 percent of firms believed all of their competitors to be fully VAT compliant. If the perceptions reflect reality, a minimum of 8.4 percent of firms evade some VAT³⁴. Firms estimated that their competitors who evade under-report legally owed VAT by around 19 percent. The average estimated unreported VAT was 21.5 percent for firms in the LTU and 15.8 percent among medium size firms (Figure 2.5).

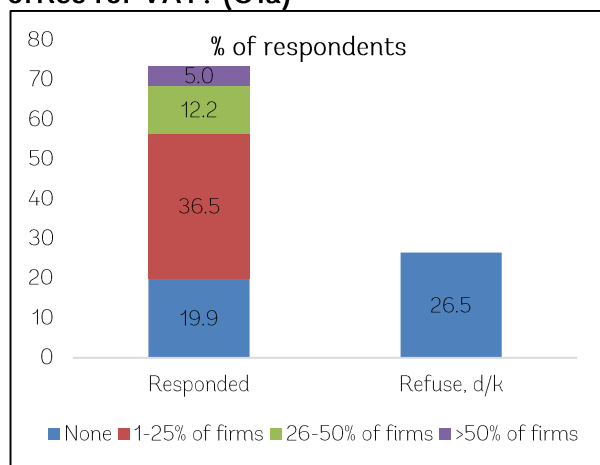
2.7. VAT evasion costs the LTU an estimated 5 percent of collections each year. If perceptions reflect actual behavior, then the cost of VAT evasion is significant. A typical firm in the LTU paid around €180,000 in VAT in 2012. Without tax evasion, average collections would have been higher. An estimated 18.1 percent of LTU firms each evade around 21.5 percent of their legally owed tax. In 2012, this cost the LTU alone around €4.5 million or 5 percent of actual

³³ The standard rate of VAT is 16 percent. There are minimal reduced rates.

³⁴ Calculation on VAT evasion: Respondents were asked to estimate how many firms in their sector evade VAT tax, among four classes “0” “1-25%” “26-50” “>50%”. To calculate the average percentage of firms evade VAT, we first use lower boundaries for each class (“0%” “1%” “26%” and “51%”) and the observed frequency to calculate the weighted average share of firms considered to underreport their VAT to the tax office. This method gives a lower bound of 8.5 percent, a linear average of 18.1 percent (using mid-points in each class) and an upper bound of 27.7 percent (using highest values from each class).

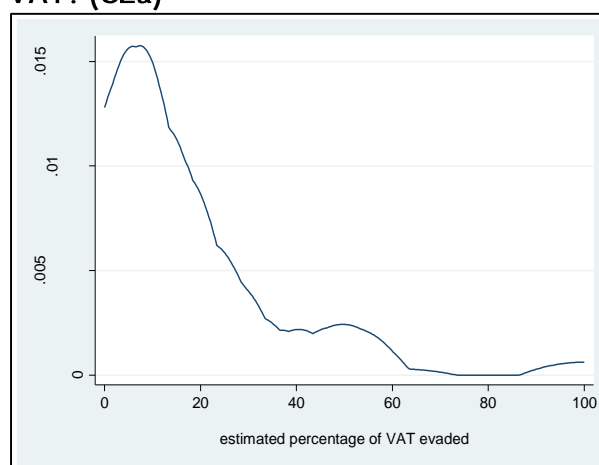
collections (full calculation methodology is presented in Appendix III). Losses for all firms combined would be even higher. The VAT “tax gap” – the difference between the VAT the tax authority should be able to collect and the amount it actually does collect – was estimated at 34 percent by a recent World Bank study (2014). If LTU firms are typical, tax evasion could account for around 15 percent of the VAT tax gap³⁵.

Figure 2.4. What proportion of firms like yours (similar size and sector) would you say declare less than they should to the tax office for VAT? (C1a)



Source: Authors' estimates using PoTI Survey.

Figure 2.5. For firms like yours, what percentage of the legally-owed tax was undeclared to the tax office last year for VAT? (C2a)



Source: Authors' estimates using PoTI Survey.

2.8. Some types of firms reported being more aware of VAT evasion than others. Regression analyses suggest that firms with female owners were less likely to be aware of VAT evasion. Just 17 percent of firms with female owners believed that their competitors under-report their VAT compared with 33 percent of firms with only ownership. If respondents reported their own behavior in part, this could reflect the consistent finding that females tend to be less corrupt than males (e.g. Dollar et al. 1999; Transparency International, 2010). Among LTUs, exporting firms and smaller firms (those with fewer than 20 employees) were more likely to report being aware of competitors that under-report revenue to evade VAT (see Table 5 in Appendix IV for regression results). Interestingly, despite firms in the construction sector reporting being aware of a lot more corruption, these results were not robust to controlling for firm characteristics (see Table 6 in Appendix IV for details).

2.9. The high non-response rate for questions on VAT evasion suggests that there is a risk of bias in the results. Nearly 27 percent of firms refused to indicate what proportion of their competitors under-report VAT. To understand better the extent of any bias, the study estimated the probability of a firm skipping the question as a function of observable firm characteristics. Older firms (those that started operations in Kosovo before 2000) were more likely to skip this question - 34 percent skipped compared with 20 percent of newer firms. Among LTUs, the regression results showed that firms with female ownership, those in Prishtina and limited liability companies (LLCs) were more likely to answer this question than other firms. About 50 percent of the respondents also refused to estimate what percentage of VAT was

³⁵ 5 percent of 34 percent is around 15 percent.

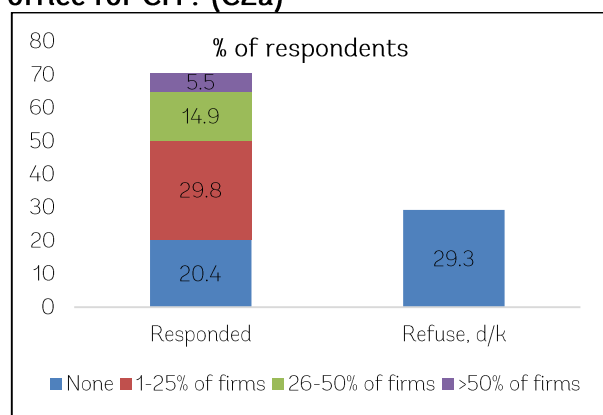
underreported. Regression results indicate that older firms were more likely to skip the question than younger firms (60 percent versus 44 percent). Among LTUs, there is no statistical evidence indicating any difference between refusals and respondents (see Table 8 in Appendix IV for details). Although there is risk of bias, even under the most benign case, in which all refusals would have reported full compliance, 54 percent of firms still reported some tax evasion in the case of VAT.

Corporate Income Tax

2.10. Around half of firms believed their competitors under-declare revenue to evade the Corporate Income Tax. About 30 percent of the respondents believed that between 1 percent and 25 percent of their competitors under-report revenue to evade the Corporate Income Tax (CIT) and another 20 percent of firms estimated that over 25 percent do so (Figure 2.6)³⁶. Around 20 percent of respondents were unaware of any tax evasion practice for CIT by other firms. If the reality is reflected in these perceptions, at least 10.7 percent of firms in the LTU under-report to the tax office to evade CIT³⁷. On average, firms estimated that their evading competitors under-reported CIT due by a minimum of 17 percent on average (Figure 2.7). This rises to 19 percent for LTUs and falls to 15 percent for medium size firms.

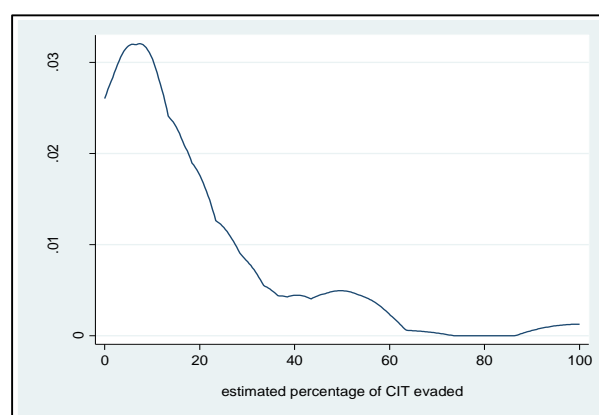
2.11. Tax evasion is estimated to cost the LTU around 5 percent annually in lost CIT collections. Based on respondents' views, lost revenue is estimated to be worth €1.7 million per year (4.8 percent of CIT collections in 2012) as a result of LTU firms alone evading CIT (a full calculation methodology is presented in Appendix III). If other firms behave similarly to LTU firms, evasion may account for as much as a quarter of the CIT tax gap, which is estimated at 17 percent in a recent World Bank study (2014).

Figure 2.6. What proportion of firms like yours (similar size and sector) would you say declare less than they should to the tax office for CIT? (C2a)



Source: Authors' estimates using PoTI Survey.

Figure 2.7. For firms like yours, what percentage of the legal value was undeclared to the tax office last year for CIT? (C2b)



Source: Authors' estimates using PoTI Survey.

³⁶ The upper rate of CIT is 10 percent.

³⁷ Steps for calculation on CIT are as steps for calculating VAT footnote [x]. The lower bound is 10.7 percent. A linear average of 20.7 percent (using mid-points in each class) and an upper bound of 30.7 percent (using highest values from each class).

2.12. Firms that believed competitors evade CIT had similar characteristics to those that believed their competitors evade VAT. As with VAT, firms with female owners were less likely to report being aware of any tax evasion by other firms. About 36 percent of firms with female owners considered their competitors to report fully for CIT purposes compared with 17 percent for firms without any female owner. Among LTUs, firms that exported and smaller firms (with fewer than 20 employees) were more likely to report tax evasion by other firms (see Table 9 in Appendix IV for details). Among LTUs, when reporting the estimated amount of CIT evaded, accounts or finance managers were more likely than other respondents to be aware of tax evasion (see Table 11 in Appendix IV). Despite the large differences for the construction sector, these were not robust to controlling for firm characteristics (see Table 12 in Appendix IV).

2.13. The questions related to CIT evasion had a high refusal rate, a similar result to VAT evasion. About 30 percent refused to indicate what proportion of competitors evaded CIT (C2a) and over half refused to indicate how much (C2b). Regression models suggest that newer firms were more likely to refuse to answer both questions than older firms³⁸. Firms with female owners and firms in Prishtina were more likely to respond, and these differences are statistically significant both for the whole sample and specifically for LTUs. LLCs were more likely to estimate the amount of CIT evaded by their competitors than were other firms (see Table 10 in Appendix IV). Even if all non-respondents are assumed to believe all of their competitors to be fully compliant, over half of firms still reported some tax evasion for CIT.

Personal Income Tax

2.14. Respondents were more inclined to believe that their competitors correctly reported employment and worker salaries than their taxable turnover. Around 38 percent of respondents believed that their competitors report all their employees to the tax office (Figure 2.8). More than a third of the respondents estimated that fewer than 25 percent of employees were unreported. On average, LTU firms estimated that a minimum of 4.9 percent of their competitors' employees were unreported to the tax office³⁹. Some firms believed that their competitors also under-report their employees' salaries. Nearly a third (32 percent) of firms believed that their competitors under-report their staffs' salaries by between one and 25 percent of their employees' salaries to the tax office, while 18 percent believed that firms reported less than 25 percent of employees' salaries. Just over one third of respondents believed other firms fully reported their employees' earnings (Figure 2.9).

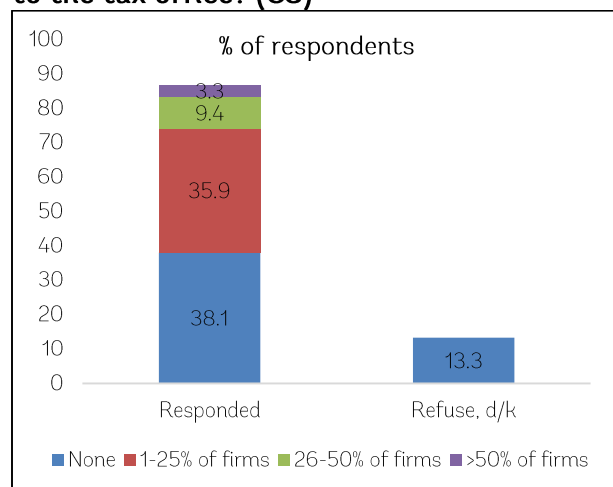
2.15. Lost tax revenues from missing workers alone is estimated at 12 percent of 2012 PIT collections. The mid-range estimate of the proportion of workers that were unreported to the tax office is 11.6 percent. This estimate implies around 15,000 un-reported workers in the country among VAT registered firms alone. Average pre-tax earnings of around €420 and an average tax rate of 4.2 percent imply losses of €3.3 million per year or about 12 percent of 2012 PIT collections (see Appendix III for calculation details). This excludes additional losses arising from under-reporting of salaries (a minimum of 6.6 percent of workers earned more than is

³⁸ 40 percent versus 25 percent for question C2a and 60 percent versus 43 percent for question C2b.

³⁹ Steps for calculation on PIT are the same as steps for calculating VAT stated above. The lower bound is 4.9 percent. A linear average of 11.6 percent (using mid-points in each class) and an upper bound of 18.3 percent (using highest values from each class).

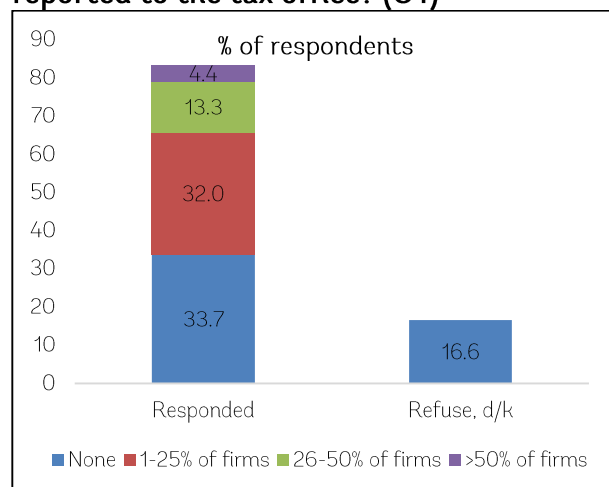
reported, according to the respondents). It was not possible to estimate these losses due to insufficient data.

Figure 2.8. For firms like yours, what percentage of total employees is unreported to the tax office? (C3)



Source: Authors' estimates using PoTI Survey.

Figure 2.9. For firms like yours, what percentage of employees earns more than is reported to the tax office? (C4)



Source: Authors' estimates using PoTI Survey.

2.16. There are sectoral differences in perceived PIT evasion practice. Regression results indicate that firms in the manufacturing sector were more likely to be aware of PIT evasion by other firms than firms in the service sector. About 55 percent of manufacturing firms believed that their competitors conceal some employees' earnings from the tax office, while 46 percent of firms in the service sector believed the same (see Table 15 in Appendix IV). Among LTUs, firms with fewer than 20 employees were more likely to report that their competitors under-report their total number of employees to the tax office (see Table 13 in Appendix IV).

2.17. PIT payment questions may have been viewed as less sensitive than questions about VAT and CIT since fewer firms chose to skip these questions. About 13 percent of respondents skipped the question on under-reporting of employees. Regression analysis showed that firms outside Prishtina and older firms (started before 2000) were more likely to skip this question. Among LTUs, exporters and firms outside Prishtina were more likely to refuse to answer this question (see Table 14 in Appendix IV). Approximately 17 percent of the respondents refused to answer the question on under-reporting of salary. Regression analysis showed that firms outside of Prishtina were more likely to skip this question (21 percent) than firms in Prishtina area (7 percent). Over a quarter of older firms refused to answer this question compared with approximately 12 percent of younger firms. Among LTUs, importers and firms based in Prishtina were less likely to skip the question (see Table 16 in Appendix IV for details). As with other questions, non-observables make it difficult to just the direction of bias. Nonetheless, sensitivity analysis showed that even under the 'least corruption' scenario in which refusals were unaware of any under-reporting, nearly half of all firms believe that their competitors under-report employment and wages.

Box 2.3. Public Procurement

Many firms surveyed have experience bidding for government contracts. In addition to asking respondents about their views of the implementation of tax law, the PoTI survey asked firms for their views on public procurement. Almost one in three firms in the sample had bid for government contracts in the last two years and about 71 percent of those participants eventually won the contracts. Construction firms were more likely to have bid for a government contract: almost half (47 percent) of construction firms surveyed bid, whereas, only a quarter of non-construction firms bid for government contract in the past two years. Out of these construction firms, 30 percent eventually won contracts, compared with 19 percent for non-construction firms. However, regression results show this difference is statistically insignificant (see Table 17 in Appendix IV for details).

The procurement process appears to be rife with non-competitive practices. Over two thirds of those participants admitted to being aware of illegal or non-competitive practice among competitors to win government contracts. On average, around 65 percent of respondents were aware of illegal or non-competitive practices by their rivals, while 4 percent of the respondents refused to answer questions related to the topic (Table 2.1). However, there were large differences between construction firms – where 79 percent were aware of illegal practices and 86 percent were aware of non-competitive practices – and non-construction firms, where 61 and 58 percent respectively of respondents knew of such practices. The survey does not provide any indication of the reasons for these large differences. However, the contract amounts involved in construction bids are relatively large, raising the incentives to cheat.

Table 2.1. Awareness of Illegal and Non-Competitive Practices in Public Procurement

	Construction	Non-construction
Are you aware of any illegal (such as bribery) practices applied by rival bidders to increase their chances of winning government contracts?"		
Yes	78.6	60.5
No	21.4	34.2
Refuse/no answer	0	5.3
Are you aware of any non-competitive (such as seeking to influence a friend) practices applied by rival bidders to increase their chances of winning government contracts		
Yes	85.7	57.9
No	14.3	36.8
Refuse/no answer	0	5.3

Source: Authors' estimates using PoTI Survey.

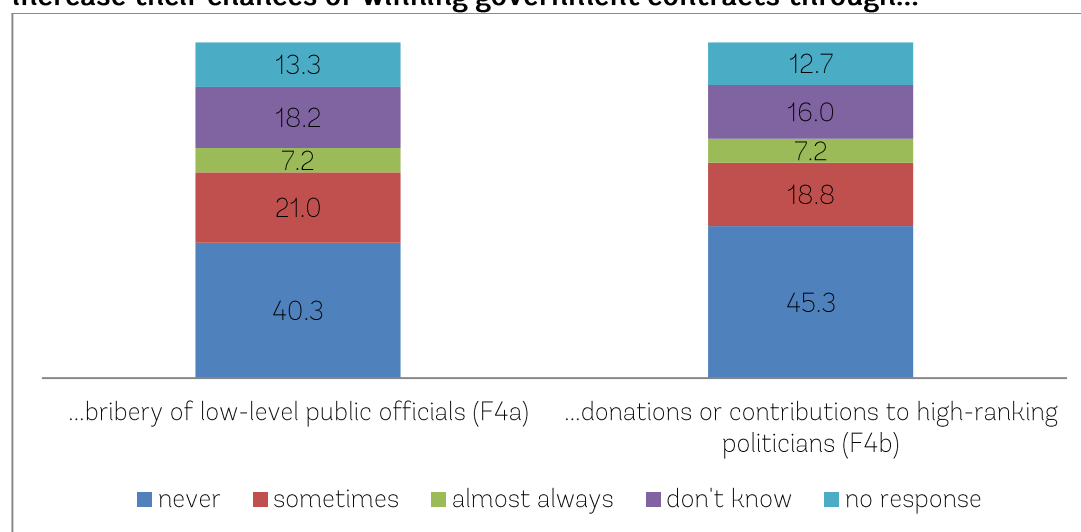
Firms with female ownership were more likely to bid for government contracts, yet were less likely to win a contract. In the past two years, over half of female owned firms bid for at least one government contract, compared with 24 percent of male-owned firms. However, regression analysis indicates that firms with female owners were less likely to win contracts, even after controlling for other characteristics (see Table 17 in Appendix IV for details).

Some other types of firms also did well bidding for government contracts. Medium-sized firms, export firms and older firms (started operation before 2000 in Kosovo) were also more likely to win contracts. The findings are all statistically significant (see Table 17 in Appendix IV for details), but it is not clear why these characteristics were associated with a higher probability of winning.

Among bidders, firms winning government contracts were more likely to be aware of illegal/non-competitive practices. About 76 percent of firms that won contracts from the government were aware of illegal practices by their competitors, significantly higher than the ratio for their losing counterparts (56 percent). Similar results hold for non-competitive practices⁴⁰ (Figure 2.10). This may indicate that there exists a class of naïve firms that fail to win contracts because they do not believe that bribery is required to win (see Table 18 in Appendix IV for details).

Bribing low ranking officials and donating funds to high-ranking ones is rife. Respondents were asked to estimate how often they think their competitors engage in specific illegal/non-competitive practices to win government contracts: bribery of low-level officials, donations or contributions to high-ranking politicians. Around 28 percent of respondents believed that bribery of low-level officials sometimes or almost always occurs when bidding for public contracts. Almost as many (26 percent) believed that donations or contributions to high-ranking politicians occur.

Figure 2.10. % of respondents indicating how often firms in their sector try to increase their chances of winning government contracts through...



Source: Authors' estimates using PoTI Survey.

Medium-sized firms were more likely than firms in the LTU to be aware that competitors bribe low-level public officials. For example, about 40 percent of medium size firms answered that their competitors sometime engage in bribery of low-level public officials. This compares with around 30 percent of firms in the LTU that believed that their competitors bribe low-level officials (see Table 19 in Appendix IV for details).

There is a high refusal rate pertaining to questions on cheating to win a government contract. Around 30 percent of respondents refused to answer these questions or indicated they did not know. Medium size firms and firms that export were more likely to either refuse to answer or choose “don’t know” than their LTU or non-exporting counterparts. New firms (those that started operations since 2000) were less likely to skip the question on “bribery of low-level public officials” than old firms (see regression results in Table 20 in Appendix IV for details).

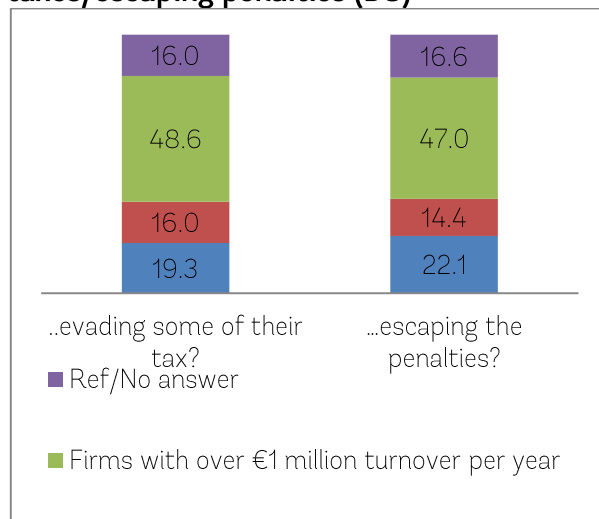
⁴⁰ 74 percent of firms that knew of non-competitive practices won government contracts, compared with 63 percent among firms that were unaware of such practices.

D. EVADING TAXES AND ESCAPING PENALTIES

2.18. The survey suggests that large and small firms, in terms of turnover, were more successful than medium-sized firms at escaping some of their tax obligations and penalties. Around 19 percent of respondents reported that the smallest firms (those with a turnover of less than €200,000 per year) were most successful in evading taxes, while 49 percent believed that the largest firms were the most successful overall (Figure 2.11). Results were similar for escaping penalties. Only 15 percent of respondents believed that medium-sized firms were most successful. It could be that smaller firms are better able to “fly below the radar” and avoid detection while larger firms have alternative ways to avoid taxes or penalties.

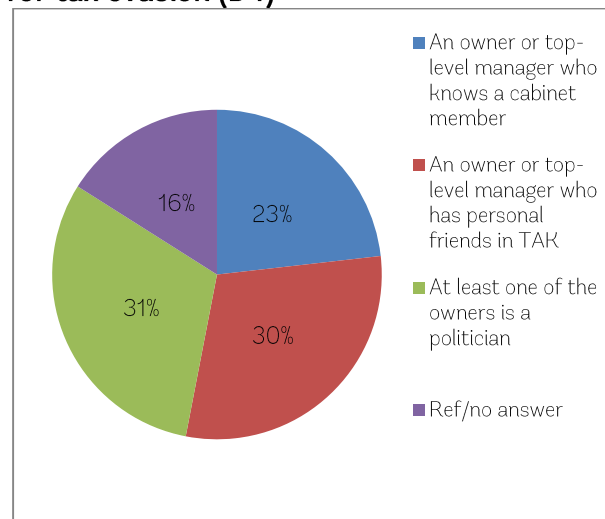
2.19. Political connections were considered helpful in escaping severe penalties for tax evasion. Around 31 percent of respondents believed that ‘at least one of the owners being a politician’ is the single most helpful way to escape a severe penalty for tax evasion (Figure 2.12). Another 30 percent of respondents believed that the single most helpful way to avoid a penalty is to have “an owner or top-level manager who has personal friends in TAK”.. Interestingly, having connections within cabinet is considered the most helpful by only 23 percent of respondents.

Figure 2.11. % of respondents indicating size of firm most successful in evading taxes/escaping penalties (D3)



Source: Authors' estimates using PoTI Survey.

Figure 2.12. % of respondents indicating the most helpful way to avoid a severe penalty for tax evasion (D4)



Source: Authors' estimates using PoTI Survey.

2.20. Firms with female ownerships, those outside Prishtina region and firms in the service sector were more likely to skip the question regarding helpful ways to escape a penalty. Regression results indicate that 27 percent of firms with female ownership were more likely to skip this question compared with 14 percent of other firms. Almost one in five firms outside Prishtina refused to answer this question, significantly higher than firms in Prishtina (9 percent). About 20 percent of firms in the service sector skipped this question compared with 10 percent of firms in the manufacturing sector (see Table 24 in Appendix IV for details).

E. CONCLUSIONS

2.21. **Tax evasion is perceived to be rife and costly in Kosovo.** It costs the public sector an estimated 5 percent of CIT and domestically collected VAT every year. The wider social and economic impacts are also significant with harm caused also to the compliant private sector, increasing their taxes, reducing the level of public service and potentially discouraging foreign direct investment. There is a real risk of a downward spiral into non-compliance as firms evade tax to compete with their competitors, whom they believe do the same.

2.22. **The survey found some striking results.** For example, sensitivity analysis showed that even under the 'least corruption' scenario in which refusals were unaware of any under-reporting, nearly half of all firms believe that their competitors under-report employment and wages.

2.23. **Tax evasion is at least perceived to enjoy high-level collusion.** The survey found that largest firms – likely with high-level contacts – were considered to be the most successful in evading taxes and escaping penalties. In addition, having political connections is considered to be the most helpful way to escape a severe penalty for tax evasion. However, low-levels are not immune from corruption either, with around 28 percent of respondents believing that bribery of low-level officials sometimes or almost always occurs when bidding for public contracts.

2.24. **Countering this perceived corruption will not be easy but is possible.**

- Better monitoring and controls in the tax administration will help. A good first step to estimating the amount of revenue lost to tax evasion – through corruption or other means – would be to implement random audits as well as the existing risk-based audits.
- Legal institutions also need to be strengthened to allow a willing tax administration to successfully pursue tax evaders through the legal system.
- Ultimately however, a more widespread social rejection of tax evasion is likely to be required. This will be particularly important in light of reports that even a willing tax administration is not always to prosecute some non-compliant taxpayers due to a dysfunctional and sometimes corrupt legal system.

CHAPTER 3. TAX GAP ANALYSIS: TECHNICAL REPORT⁴¹

A. KEY MESSAGES

- **As noted in chapter 1, Kosovo collects a smaller share of GDP in revenue than its neighbors.** While it may not be advisable to smother its nascent private sector and its comparatively poor citizens in taxes, reducing tax evasion can help to reduce unfair competition in the private sector and ensure a sustainable revenue stream to finance necessary public investment in infrastructure, health and education.
- **This technical chapter estimates the size of the shadow economy and the tax gap for the main taxes separately.** First, it estimates the size of Kosovo's shadow economy, which is difficult for the Tax Administration of Kosovo (TAK) or the Kosovo Customs Agency to access. It then focuses on estimating the tax base for Value-Added Tax (VAT), Personal Income Tax (PIT) and Corporate Income Tax (CIT) using, as far as possible, a "bottom up" approach based on micro-level data. From these estimates, the tax potential is calculated and compared with actual tax revenues to provide measures of the "tax gap" for each tax. In addition, the analysis looks specifically at revenues from tobacco and alcohol.
- **The key results are:**
 - The estimated size of the underground economy during 2004-2011 is between 7.5 and 18.8 percent.
 - The estimated VAT potential in 2011 was €718,893,733 - as compared to the actual receipts reported for 2011 of €536,453,103. Thus the estimated VAT gap in 2011 was approximately 34 percent of the present collection.
 - The estimated potential for PIT collections was about 3.5 times higher than actual collections.
 - The estimated potential for CIT collections was around 19 percent higher than collection in 2012 using baseline assumptions on the probability of evasion of non-audited firms. The range for this proportion using ranges of probability of evasion for the total sample between 20 and 53 percent for large and LTU firms and between 33 and 66 percent for other firms gives us a range of potential tax gap for CIT of 12 to 27 percent of actual collections in that year.
 - The estimated amount of tax collections from cigarettes is lower than present collections. Therefore, either the household consumption is severely under-reported, or a very large part of imports plus domestic production is being diverted (possibly after payment of duty and VAT) to other countries where prices are higher.
- **It should be noted that, while this chapter aims to explain clearly the choices made, including the assumptions required for the estimations, it should be**

⁴¹ Chapter prepared by Sandeep Bhattacharya, Munawer Khwaja and Simon Davies.

considered as a technical report. It is not therefore likely to be accessible to all readers.

B. SHADOW ECONOMY

3.1. Since much tax evasion takes place in the underground economy, we begin this analysis by estimating the size of the shadow economy in Kosovo. There are several ways to estimate this:

- a) Estimated difference between gross domestic income and gross domestic expenditures after adjusting for statistical discrepancy;
- b) Estimated difference between the official estimates of the labor force and independent reliable estimates of the actual labor force, given a stable labor force participation rate;
- c) Total money value of all final transactions in a year minus the official estimate of nominal GDP in that year where $\text{GDP underground} = \text{Money} \times \text{Velocity} - \text{GDP official}$ and Money (M), Velocity (V) are estimates available from the central bank or IMF. This method will not work for Kosovo since V is calculated by dividing GDP by M.
- d) Tanzi's modified currency demand approach is the most common approach, and the one we employ. It requires as long as possible annual time series of total currency (stock) holdings or estimates for demand for money, GDP deflator, total direct taxes, GDP, total indirect taxes, average interest rate, average inflation rate, average number of bank branches and Automatic Teller Machines (ATMs, or other indicator of financial deepening). Data are available from the Central Bank on total currency (stock) holdings or estimates for demand for money, average interest rate, average number of bank branches and ATMs (and other indicator of financial deepening – currency to demand deposits ratio), on annual basis from 2001 and quarterly basis from 2004, as well as last 3 years average velocity of money. Quarterly information on GDP is not available however. Therefore, the estimation is conducted on an annual basis only from 2004.

3.2. The Tanzi model derives the size of the shadow economy and the potential overall tax evasion by estimating the size of the demand for money. It postulates that the shadow economy relies on cash transactions and increases with the tax burden. As the overall tax burden on the economy increases, more of the economy is driven underground. Since this shadow economy relies exclusively on cash, an increase in the size of the underground economy disproportionately increases the demand for currency. The model relies on estimating the demand for currency as a function of several variables including the tax rate and then estimating the demand for currency without taxes. This difference, assuming a stable velocity of money or currency to disposable income ratio, will give an estimate of the size of the underground economy, which is largely out-of-reach of the tax system.

3.3. As is immediately obvious, the crucial link is the dependent variable in this case the estimated demand for currency. Not all possible specifications of the model (following Faal, 2003) could not be attempted due to the availability of only eight years of complete data (from 2004 to 2011). With only eight observations, very few degrees of freedom are preserved as

variables increase, and normal time series methods such as differences and lags do not have much meaning. The data made available is presented in Table 3.1.

Table 3.1. Data Provided for Tanzi Model

		2004	2005	2006	2007	2008	2009	2010	2011
Currency in circulation	millions of euro	583.9	601.4	624.1	674.3	754.5	766.2	821.4	833.0
Gross domestic product, current prices	millions of euro	2913	3003	3120	3394	3851	3912	4216	4637
Inflation, end of period consumer prices		98.1	98.8	99.9	110.4	110.9	111	118.3	122.5
General government revenue	millions of euro	615	628	720	898	943	1146	1164	1305
Direct taxes	millions of euro	83.9	101.6	133.2	159.7	201.4	167.9	165	184.7
Euro Area: Marginal Lending Facility Rate (EOP, %)		3.0%	3.0%	3.9%	4.9%	4.7%	2.1%	1.8%	2.0%
total ODC network units		218	237	220	236	287	295	311	310
CBK monetary base to liabilities ratio		32%	37%	22%	16%	18%	30%	20%	20%
Disposable income	millions of euro	2829.1	2901.4	2986.8	3234.3	3649.6	3744.1	4051	4452.3
AETR		21%	21%	23%	26%	24%	29%	28%	28%
currency/DY ratio		21%	21%	21%	21%	21%	20%	20%	19%

Source: World Development Indicators; IMF; Central Bank of Kosovo; Ministry of Finance.

3.4. Due to the shortage of observations, simple models of forecasting were used. Differencing and lags lead to the loss of one year, and introducing a simple time trend leads to the loss of one degree of freedom due to one additional coefficient. However, using differences led to the semi-elasticity of the difference of annual currency demand with respect to the tax rate being negative which is the opposite of what we expect. Using a trend may not solve for difference stationary issues, but at least the semi-elasticity is positive for the most parsimonious model with and without a time trend. Based on this, the size of underground disposable income is presented in Table 3.2.

Table 3.2. Table 3.2. Results from Tanzi Model

			2004	2005	2006	2007	2008	2009	2010	2011
Underground Disposable Income as Proportion of DI no Time Adjustment			14.0%	14.0%	15.0%	17.0%	15.5%	18.8%	17.1%	16.7%
Underground Disposable Income as Proportion of DI - Time Adjustment			7.5%	7.6%	8.3%	9.3%	8.5%	10.3%	9.5%	9.1%

Source: Authors' estimates.

3.5. The specification of the model chosen leads to estimates of the underground economy with a range varying from a possible minimum of 8 percent to a possible maximum of 19 percent. This may be an underestimate to the extent the dependent variable (cash in circulation) is underestimated as it is most probably estimated with reference to measured GDP. If the estimation of currency in circulation is robust, it may not be an inaccurate range notwithstanding the estimation, data and model specification issues.

C. VALUE-ADDED TAX

3.6. The VAT base was estimated using: (i) household expenditure from the Household Budget Survey, government expenditure data; (ii) data for expenditure by NGOs (Non-Profit Institutions Serving Households, NPISH) supplied by national accounts; (iii) turnover by NACE classification; (iv) the 2005-06 Supply and Use Table (SUT); and (v) other information described below. All data available was for 2011, and in the absence of further information the tax code supplied by TAK was used with this data under the assumption that the tax code had not changed much since 2011.

3.7. The household consumption data from the 2011 Household Budget Survey (HBS) provided a detailed breakdown of household expenditure, some of which attracts VAT. Health, education, owner occupied housing were taken as completely exempt categories as were 50 percent of 'miscellaneous'; since it is assumed that financial services, market rentals and other unspecified products are included here. For firms, spending above VAT thresholds was taken as averages of categories from the turnover by NACE files provided by the national accounts office. These cannot be treated as exact and are approximate figures made necessary by assumptions, as retail and wholesale trade is listed as separate categories for many goods. Since households tend to buy most goods on a retail basis, estimates were made for total values including wholesale and retail value added. The turnover thresholds can certainly be improved with more precise inputs (by household expenditure category).

3.8. Estimates place the consumption base at around €4.4 million. After removing tax exemptions worth an estimated €0.6 million, applying the VAT threshold (share of sales in sector undertaken by firms whose turnover falls below the VAT threshold) and the applicable VAT rate, total VAT receipts resulting from household consumption were estimated to come to close to €0.5 million in 2011 (Table 3.3).

Table 3.3. Calculations of the VAT from the Household Consumption Tax Base

Item	Total	share above threshold	taxable proportion	total exempt due to threshold	tax base plus tax	net of tax consumption including below threshold excluding exempt	tax	value exempt	below threshold taxable	total2
Total FOODS	1,621,676,011	95%	1	5%	1,621,676,011	1,407,704,870	213,971,140		70,385,244	1,621,676,011
Alcohol & tobacco	251,500,859	98%	1	2%	251,500,859	217,410,839	34,090,020		4,348,217	251,500,859
Clothing & footwear	252,528,355	85%	1	15%	252,528,355	222,296,087	30,232,268		33,344,413	252,528,355
Imputed rentals of owner-occupiers (S)	419,204,200		0					419,204,200		419,204,200
water and fuel	266,291,533	99%	1	1%	266,291,533	229,878,740	36,412,792		2,298,787	266,291,533
Furnishing 5	399,711,768	95%	1	5%	399,711,768	346,972,021	52,739,747		17,348,601	399,711,768
Health	107,662,325		0					107,662,325		107,662,325
Transport	608,447,510	97%	1	3%	608,447,510	526,703,177	81,744,333		15,801,095	608,447,510
Communication	135,836,393	98%	1	2%	135,836,393	117,424,268	18,412,125		2,348,485	135,836,393
Recreation and culture	134,681,404	85%	1	15%	134,681,404	118,557,574	16,123,830		17,783,636	134,681,404
Education 10	46,324,810		0					46,324,810		46,324,810
Hotels and restaurants	65,497,562	70%	1	30%	65,497,562	58,900,685	6,596,877		17,670,205	65,497,562
Miscellaneous	118,840,569	85%	0.5	15%	118,840,569	55,636,971	7,566,628	55,636,971	8,345,546	118,840,569
	4,428,203,299					3,301,485,232	497,889,760	628,828,306	189,674,230	4,428,203,299

3.9. Similar calculations were attempted for government and NPISH, but the information available was not differentiated in the level of detail as the household level data. For government, the VAT base included government purchases of (taxed) goods and services whether classified as current or capital expenditure. For current expenditure, it is possible to remove intermediate inputs (which are not subject to VAT) into government expenditure, but not for government Gross Fixed Capital Formation (GFCF). The biggest concern in this category was that there was a possibility that government GFCF may have included some non-commodity expenditures or some wages and salaries. The entire spending on capital projects gets included in GFCF, including exempt services and salaries. To correct for this, a larger correction is made to the exempt category in government GFCF than for other areas subject to VAT.

3.10. In total, government purchase of goods and services amounted to €951.7 million, of which GFCF was worth €580.9 million and government consumption (termed intermediate consumption or IC) €370.8 million. After removing exemptions and applying the share of goods and services purchased from firms below the VAT threshold, €106.5 million of tax is expected to be paid by the public sector (Table 3.4).

Table 3.4. VAT Base from Government Consumption Expenditure and Government GFCF

IC BASE	below threshold	exempt services	IC w/o tax incl below threshold	tax	below threshold	exempt	tax base
370.8	5%	2%	322.7614684	48.0	16.13807342	6.455229367	300.1681656
GFCF base	below threshold	exempt services	GFCF w/o tax incl below threshold	tax	below threshold	exempt	tax base
580.9	5%	25%	522.3745455	58.5	26.11872728	130.5936364	365.6621819
total IC + GFCF							
951.7			845,136,014	106,532,856	42,256,801	137,048,866	665,830,347

Source: Kosovo Agency of Statistics, Tax Administration of Kosovo, Ministry of Finance, Authors' estimates.

3.11. The last component in this category is NPISH, for which we only have aggregated data for total expenditures. The results are presented in Table 3.5. Tax totaling around €1.8 million was estimated for this sector.

Table 3.5. VAT Base from NPISH Expenditure

IC BASE	below threshold	exempt services	IC w/o tax incl below threshold	tax	below threshold	exempt	tax base	tax
14222066	5%	2%	12379932	1842134	618997	247598.6	11513337	1842134

Source: Kosovo Agency of Statistics, Tax Administration of Kosovo, Ministry of Finance, Authors' estimates.

3.12. The final adjustments to be made are: (1) including GFCF for VAT exempt sectors or firms and (2) estimating the expenditures by exempt firms or sectors in the taxed firms or sectors. From the SUT, total production of exempt sectors excluding public administration (whose GFCF is already included in purchases of goods and services by government) was around 12 percent of the total, and including below threshold firms a ratio of 15 percent was taken and applied to total gross capital formation for 2011, which was reduced by half to account for exclusion of 117,106,200 for GFCF in exempt sectors. For expenditures of exempt sectors purchased from taxed sectors, calculations from the TAK VAT by line report and turnover by NACE file yield exempt residential construction. This provides a figure of ratios between 69-78 percent, so a conservative estimate of 60 percent of exempt sales was taken – this provides the figure of 599,204,879.

3.13. The total VAT tax gap is around a third of present collections. Summing VAT from each source gives potential VAT collections of 718,893,733 (Table 3.6). In 2011, TAK reports VAT revenues as 121,437,993 and Customs reports border VAT at 415,015,110 which adds up to 536,453,103. This implies that the VAT gap is approximately 34 percent or so of the present collection.

Table 3.6. VAT Base from Consumption Approach

		Sources of data	AMOUNT
VAT Base			
=	Final Private Consumption Expenditure	From HH survey 2011 PFCE excel file (National Accounts) + Turnover by NACE (NA)	3,930,313,538
+	Gov't Purchases of Goods and Services	GenG + NPISH intermediate cons and GFCF (National Accounts) + Turnover by NACE (NA)	845,136,014
Adjustment A: Final Private Consumption Expenditure			
-	Exempt Final Consumption Expenditure	From HH survey 2011 PFCE excel file (National Accounts)	628,828,306
-	Below Threshold Consumption Expenditure	From HH survey 2011 PFCE excel file (National Accounts) + Turnover by NACE (NA)	189,674,230
Adjustment B: Government Expenditure on Goods & Services			
-	Exempt Government Expenditure	GenG + NPISH intermediate cons and GFCF (National Accounts) and TAK report	137,296,464
-	Below Threshold Government Expenditure	GenG + NPISH intermediate cons and GFCF (National Accounts) and TAK report + Turnover by NACE (NA)	42,875,797
Adjustment C: Capital Formation			
+	Gross Capital Formation in Exempt Sectors	GDP by expenditure 2006-11 + SUT table 2005-06 (National Accounts)	117,106,200
Adjustment D: Intermediate Sales (Cascading) + Adjustment E: Exemption Threshold			
+	Input of Exempt Sectors Purchased from Taxed Sectors	Exempted sales above and TAK annual report + Turnover by NACE (NA)	599,204,879
TOTAL VAT BASE			4,493,085,833
VAT POTENTIAL			718,893,733

D. PERSONAL INCOME TAX

3.14. The 2011 HBS provides some information on household income. It was assumed that the PIT brackets and rates in 2011 were not substantially different from the system at present. Taxable PIT income was estimated at just under €1.4 billion resulting in tax revenue of about €53.4 million (Table 3.7). In reality, in 2011, TAK collected revenues from withholding tax worth €55.7 billion (Table 3.8), greater than estimated potential.

Table 3.7. Average Annual Income from HBS Survey 2011

INCOME CLASS	NUMBER OF PERSONS IN SAMPLE	AVERAGE ANNUAL INCOME OF PERSONS FROM ALL SOURCES (in cash) IN THIS CLASS FROM SAMPLE = TOTAL INCOME OF PERSONS OF THIS CLASS IN SAMPLE / NUMBER OF PERSONS IN THIS CLASS IN SAMPLE	POPULATION WEIGHT FOR PERSONS	MTR	TAX PER PERSON	TOTAL TAX	TOTAL INCOME	ATR	SHARE OF TOTAL INCOME	SHARE OF TOTAL TAX
0-960 eur/year	952	672	155707	0%		0	104,582,111	0.00%	8%	0%
961-3000	1318	2214	160183	4%	50	8,034,779	354,645,162	2.27%	26%	15%
3001-5400	1112	4091	148656	8%	169	25,101,261	608,104,639	4.13%	44%	47%
5401+	302	8153	36973	10%	549	20,295,826	301,454,336	6.73%	22%	38%
					TOTAL	53,431,866	1,368,786,249	3.90%	100%	100%

Source: Kosovo Agency of Statistics, Tax Administration of Kosovo, Ministry of Finance, Authors' estimates.

Table 3.8. TAK Annual Performance Report

Tax type	Revenues by years		
	2010	2011	2012
Profit tax	582,999	1,792,756	116,197
Withheld tax	44,208,930	55,668,304	60,089,290
Tax on individual business	25,466,740	23,517,097	25,916,434
Interest, rental , property right etc.	2,932,560	1,375,507	1,630,724
Other	732,795	1,898,361	3,100,088
Total	73,926,034	84,254,036	90,854,745

Source: Tax Administration of Kosovo, Ministry of Finance.

3.15. This would have been a good result but for the fact that total household consumption from the same survey used in the VAT forecasting puts total household consumption in 2011 at 4,428,203,299 or about 3.25 times the estimated income. If we conservatively take income as equal to consumption, it would mean that the tax potential could be as high as three times the estimate of potential from the present income data.

E. CORPORATE INCOME TAX

3.16. It was not possible to obtain firm level data to analyze firm turnover, expenses and profits, which would have been ideal to understand better the tax base for Corporate Income Tax (CIT). Instead, the CIT gap was estimated using data on firm audits provided by TAK (columns 1-9, Table 3.9). The data provide the total CIT audits conducted, broken down by region and class of firm, as well as the CIT actually realized during the year as a result of the audits⁴².

3.17. The audit data was used to estimate CIT revenue potential. The potential additional tax realization from audits (column 10) was taken as the average CIT collected this year from firms audited and multiplied by the total firms in each category to get an estimate of how much tax may have been collected if all firms had been audited during the year and the audit selection was purely random. This is expressed as a percentage of actual CIT receipts during the year in column 11. For the country as a whole, the potential calculated in this way is around 48 percent of the total collections of CIT. However, it is clear that this overstates the potential since audit selection is based on a risk management strategy, and firms are not picked randomly for audit but based on some unknown probability of evasion. Therefore, the potential has to be revised downward based on subjective probability of the firms not selected for audit to evade.

3.18. However, the table shows that the audit detection for micro and medium firms is much larger (revenue potential is 451 and 75 percent of actual collections, respectively) than for large and LTU firms (potential at 36 and 34 percent). Therefore, a baseline probability for non-audited micro and medium firms was taken to be 50 percent, and a lower baseline of 33 percent was taken for large and LTO firms. The revised potential calculated in this way turned out to be 19 percent of the total CIT actually collected in 2012.

⁴² CIT not realized during the year increase the balance of tax payment arrears, while some arrears may be realized during the year from past audits, and some of this year's arrears may be written off or rejected by courts in later years. Either way we do not take them into account to calculate this year's tax gap since we have data for total receipts of CIT and we do not have data required yet to convert receipts to revenues as data in columns 8 and 9 requested were not available.

Table 3.9. Details of CIT Audits 2012 in Kosovo

	Region	Nr of firms	CIT 2012	Total revenues 2012	Number of Audits initiated covering CIT firms	Additional tax (no interest nor penalties)	Additional CIT tax collected	CIT not collected	Proportion of firms audited for CIT	Proportion of audit detection not collected in 2012	Potential realization from audit	Average realization from audit as % age of revenue	Weighted potential realization from audit	Weighted average realization from audit as % age of revenue
	0	1	2	3	4	5	6	7	8	9	10	11	10	11
MICRO	FERIZAJ	387	36,346	1,146,327	11	3,354	755	2,598	2.8%	77%	26,579	73%	13,290	37%
	GJAKOVĚ	350	48,779	721,887	2	54,564		54,564	0.6%	100%	-		-	
	GJILAN	407	44,408	887,908	12	146,481	2,636	143,845	2.9%	98%	89,406	201%	44,703	101%
	MITROVICĚ	277	219,951	898,992	4	5,423	5,027	395	1.4%	7%	348,147	158%	174,073	79%
	PEJĚ	359	32,598	1,011,600	3	4,847	1,711	3,136	0.8%	65%	204,807	628%	102,404	314%
	PRISHTINĚ 1	1,248	474,961	22,128,755	6	143,025	7,183	135,842	0.5%	95%	1,494,043	315%	747,022	157%
	PRISHTINĚ 2	567	139,644	1,032,649	5	116,804	4,360	112,444	0.9%	96%	494,424	354%	247,212	177%
	PRISHTINĚ 3	1,262	497,911	5,614,812	5	37,858	17,654	20,203	0.4%	53%	4,455,897	895%	2,227,949	447%
	PRIZREN	516	82,602	1,690,252	8	71,257		71,257	1.6%	100%	-	-	-	
TOTALI:	5,373	1,577,199	35,133,182	56	583,612	39,327	544,284	1.0%	93%	7,113,304	451%	3,556,652	226%	
											31		15	
SMALL	FERIZAJ	22	20,045	645,210	2	424	-	424	9.1%	100.0%	NO TAX COLLECTED	NO TAX COLLECTED	NO TAX COLLECTED	NO TAX COLLECTED
	GJAKOVĚ	32	33,425	533,225	-	-	-	-	-	-				
	GJILAN	22	11,234	601,104	1	142	-	142	4.5%	100.0%				
	MITROVICĚ	7	7,779	646,849	-	-	-	-	-	-				
	PEJĚ	19	11,950	743,596	-	-	-	-	-	-				
	PRISHTINĚ 1	71	77,440	1,204,766	-	-	-	-	-	-				
	PRISHTINĚ 2	46	55,678	629,365	-	-	-	-	-	-				
	PRISHTINĚ 3	64	66,321	843,141	-	-	-	-	-	-				
	PRIZREN	35	21,423	1,337,339	-	-	-	-	-	-				
TOTALI:	318	305,297	7,184,596	3	567	-	567	0.9%	100.0%					
MEDIUM	FERIZAJ	106	148,229	1,741,037	6	8,403	6,901	1,502	5.7%	18%	121,922	82%	60,961	41%
	GJAKOVĚ	81	119,471	1,003,239	2	188,357		188,357	2.5%	100%	-		-	
	GJILAN	113	222,395	1,485,558	6	922		922	5.3%	100%	-		-	
	MITROVICĚ	54	98,831	1,151,765	1	20,156		20,156	1.9%	100%	-		-	
	PEJĚ	96	197,276	1,655,127	3	10,033	3,082	6,951	3.1%	69%	98,624	50%	49,312	25%
	PRISHTINĚ 1	310	960,744	6,080,315	2	1,809	1,529	280	0.6%	15%	236,930	25%	118,465	12%
	PRISHTINĚ 2	209	545,161	3,417,815	1	1,144	793	350	0.5%	31%	165,825	30	82,912	15%
	PRISHTINĚ 3	284	848,528	4,907,956	10	68,699	68,699	-	3.5%	0%	1,951,052	230%	975,526	115%
	PRIZREN	179	300,041	3,310,186	13	6,267	817	5,451	7.3%	87%	11,244	4%	5,622	2%
TOTALI:	1,432	3,440,677	24,752,998	44	305,789	81,821	223,968	3.1%	73%	2,585,596	75%	1,292,798	38%	

LARGE	FERIZAJ	45	323,735	1,479,781	8	24,103	11,856	12,247	17.8%	51%	66,693	21%	22,008.61	7%
	GJAKOVË	36	200,978	1,082,489	-	-		-					-	
	GJILAN	45	328,942	1,496,023	9	54,837	6,305	48,532	20.0%	89%	31,526	10%	10,403.55	3%
	MITROVICË	26	136,351	1,227,376	-	-		-					-	
	PEJË	31	131,252	1,445,453	2	10068.6	10068.6	-	6.5%	0%	156,063	119%	51,500.89	39%
	PRISHTINË 1	120	1,491,804	7,684,057	5	21281.42	21281.42	-	4.2%	0%	510,754	34%	168,548.85	11%
	PRISHTINË 2	111	1,223,667	5,690,493	2	13523.5	13,524	-	1.8%	0%	750,554	61	247,682.90	20%
	PRISHTINË 3	142	1,618,763	6,402,208	5	89680.11	13,184	76,496	3.5%	85%	374,426	23%	123,560.45	8%
	PRIZREN	73	363,789	3,134,856	9	49063.27	24,507	24,556	12.3%	50%	198,778	55%	65,596.86	18%
	TOTALI:	629	5,819,280	29,642,737	40	262,557	100,726	161,831	6.4%	62%	2,088,794	36%	689,302	12%
LTU	NJTM	359	46,279,417	165,079,413	47	2,475,544	2,034,933	440,611	13.1%	18%	15,543,423	34%	5,129,330	11%
	TOTALI:	359	46,279,417	165,079,413	47	2,475,544	2,034,933	440,611	13.1%	18%	15,543,423	34%	5,129,330	11%
TOTALI:		8,111	57,421,870	261,792,926	190	3,628,068	2,256,807	1,371,261	2.3%	38%	27,331,117	48%	10,668,082	19%

Source: Kosovo Agency of Statistics, Tax Administration of Kosovo, Ministry of Finance, Authors' estimates.

3.19. Since this result is based on imperfect information, we conduct sensitivity analyzes on the results. Tables 3.8 and 3.9 present the tax gap in Euro and percentage terms, respectively, depending upon the probability of unaudited micro/medium sized firms evading taxes and the probability of large/LTO firms evading taxes. Specifically, the probability of the unaudited micro and medium firms varies between 33 and 66 percent as likely to evade as the audited firms in the same category and the large and LTO firms varies between 20 and 53 percent as likely to evade as the audited firms in that category. In the baseline case, the potential evasion (that can be collected in the same year) is 10,668,082, which are 19 percent of the CIT receipts of 57,421,870 in 2012. All probability combinations that yield a potential higher than the baseline are highlighted in green in Table 4.10 and in red in Table 4.11. Since the relative probabilities are known to the risk based audit selectors for non-audited firms, they can use those probabilities to pick the appropriate range of estimates for the tax potential in CIT.

3.20. Two observations deserve to be made for inter-region variation and inter-class variation. First, there are virtually no successful audits of small firms (see Table 3.9). In fact the number of firms is low in this category and the revenue is also low. Perhaps this classification may be merged with the micro firms as the only thing that is revealed by separating the two is that not much attention is being paid to small firms. While recoveries from audit are very large for micro firms, that is not the case for small firms. If this is also a separate unit in addition to being a separate category for reporting, examining small firms more closely may bear some fruit. Second, Gjakovë region has not produced audit results in any category of firm, and Ferizaj, Gjilan and Mitrovicë seem to lag in terms of results and recoveries compared to other regions. It may also bear fruit if this difference in recoveries and audit is examined more closely.

Table 3.10. Simulation Results with Probability of Evasion in Revenue Terms Reported as Value of Lost Revenues in Euro

		Probability Micro & Medium											
		33%	36%	39%	42%	45%	48%	51%	54%	57%	60%	63%	66%
P r o b a b i l i t y	20%	6,727,080	7,018,047	7,309,014	7,599,981	7,890,948	8,181,915	8,472,882	8,763,849	9,054,816	9,345,783	9,636,750	9,927,717
	23%	7,256,047	7,547,014	7,837,981	8,128,948	8,419,915	8,710,882	9,001,849	9,292,816	9,583,783	9,874,750	10,165,717	10,456,684
	26%	7,785,013	8,075,980	8,366,947	8,657,914	8,948,881	9,239,848	9,530,815	9,821,782	10,112,749	10,403,716	10,694,683	10,985,650
	29%	8,313,980	8,604,947	8,895,914	9,186,881	9,477,848	9,768,815	10,059,782	10,350,749	10,641,716	10,932,683	11,223,650	11,514,617
	32%	8,842,947	9,133,913	9,424,880	9,715,847	10,006,814	10,297,781	10,588,748	10,879,715	11,170,682	11,461,649	11,752,616	12,043,583
	35%	9,371,913	9,662,880	9,953,847	10,244,814	10,535,781	10,826,748	11,117,715	11,408,682	11,699,649	11,990,616	12,281,583	12,572,550
	38%	9,900,880	10,191,847	10,482,814	10,773,781	11,064,748	11,355,715	11,646,682	11,937,649	12,228,616	12,519,582	12,810,549	13,101,516
	41%	10,429,846	10,720,813	11,011,780	11,302,747	11,593,714	11,884,681	12,175,648	12,466,615	12,757,582	13,048,549	13,339,516	13,630,483
	44%	10,958,813	11,249,780	11,540,747	11,831,714	12,122,681	12,413,648	12,704,615	12,995,582	13,286,549	13,577,516	13,868,483	14,159,450
	47%	11,487,779	11,778,746	12,069,713	12,360,680	12,651,647	12,942,614	13,233,581	13,524,548	13,815,515	14,106,482	14,397,449	14,688,416
t O	50%	12,016,746	12,307,713	12,598,680	12,889,647	13,180,614	13,471,581	13,762,548	14,053,515	14,344,482	14,635,449	14,926,416	15,217,383
	53%	12,545,712	12,836,679	13,127,646	13,418,613	13,709,580	14,000,547	14,291,514	14,582,481	14,873,448	15,164,415	15,455,382	15,746,349

Source: Authors' estimates.

Table 3.11. Gap from CIT Based on Different Probabilities of Audit Reported as Percentage of Revenues

		Probability Micro & Medium											
		33%	36%	39%	42%	45%	48%	51%	54%	57%	60%	63%	66%
P r o b a b i l i t y	20%	12%	12%	13%	13%	14%	14%	15%	15%	16%	16%	17%	17%
	23%	13%	13%	14%	14%	15%	15%	16%	16%	17%	17%	18%	18%
	26%	14%	14%	15%	15%	16%	16%	17%	17%	18%	18%	19%	19%
	29%	14%	15%	15%	16%	17%	17%	18%	18%	19%	19%	20%	20%
	32%	15%	16%	16%	17%	17%	18%	18%	19%	19%	20%	20%	21%
	35%	16%	17%	17%	18%	18%	19%	19%	20%	20%	21%	21%	22%
	38%	17%	18%	18%	19%	19%	20%	20%	21%	21%	22%	22%	23%
	41%	18%	19%	19%	20%	20%	21%	21%	22%	22%	23%	23%	24%
	44%	19%	20%	20%	21%	21%	22%	22%	23%	23%	24%	24%	25%
	47%	20%	21%	21%	22%	22%	23%	23%	24%	24%	25%	25%	26%
t O	50%	21%	21%	22%	22%	23%	23%	24%	24%	25%	25%	26%	27%
	53%	22%	22%	23%	23%	24%	24%	25%	25%	26%	26%	27%	27%

Source: Authors' estimates.

F. A FOCUS ON SIN TAXES

3.21. This study has not aimed to go deeply into every source of revenue. However, this section presents the findings of the analysis for some of the specific sources of revenue, which may be of interest in terms of clamping down on evasion or raising additional revenue in the future.

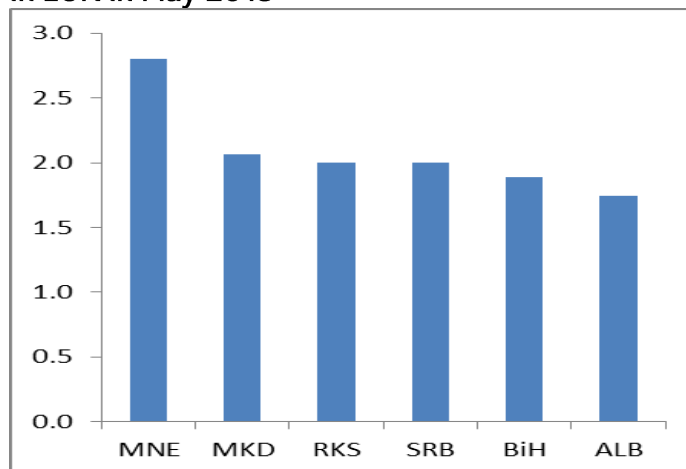
Tobacco

3.22. Total household expenditures on alcohol and tobacco are available from the 2011 HBS (Table 3.12). We can take cigarettes to be approximately €210 million and ignore other tobacco for which we do not have much information. An approximation of the cost of a packet of cigarettes for Kosovo and neighboring countries is provided in Figure 3.1. Marlboro Lights are likely among the more expensive brands and retail at approximately €2 per pack of 20 in Kosovo.

Table 3.12. Total Household Expenditures on Alcohol and Tobacco from 2011 HBS

Alcohol & tobacco	251,500,859
Spirits	7,513,445
Wine	7,273,620
Beer	25,461,865
Cigarettes	209,542,941
Other tobacco	1,708,988
<i>Source: Customs Agency</i>	

Table 3.13. Retail Cost of a Pack of 20 Marlboro Light in EUR in May 2013



Source: World Bank staff.

Table 3.14. Excise Rates for Alcohol and Tobacco (Rates Apply to 2011)		
Description	Excise	Customs duty
Alcoholic drinks	500 €/Hl abs.alk.100%vol in 20oC(1)	10%
Beer	500 €/Hl abs.alk.100%vol in 20oC(1)	10%
Tobacco (kg)	25€/kg	10%
Source: Customs Agency.		

3.23. Tax revenues from cigarettes appear to be higher than predicted from the estimated consumption base. The tax structure on tobacco and alcohol starts (in reverse) with VAT at 16 percent applied to all cigarettes, then the excise of €25 per kg (Table 3.13) and customs at 10 percent for imports only. We were informed by customs that excises were €27 per 1000 cigarettes at the time of the analysis. If we take total cigarette weight of 1.2 grams, of which tobacco weight: 0.9 gram as a standard measure, approximately at 1 gram per cigarette, we note that we have 1000 grams (or cigarettes in a kilogram) so we can take the rate for 2011 at €25 per 1000 cigarettes (each equal to 1 kilogram). A pack of twenty cigarettes would imply that 1000 cigarettes would be 50 packs. €25 EUR for 50 packs implies €0.50 per pack as excise. The customs duty that applies to alcohol and tobacco is 10 percent. Removing VAT from the household consumption in 2011 gives us a spending base including excise and customs of a little over €180 million. If we take €2 per pack as VAT inclusive, it implies around 105 million packs based on household spending, and excise would be €52.5 million and excise exclusive spending around €127.5 million. This contradicts custom figures for imports of tobacco in 2011 that are presented in Table 3.14.

3.24. Taking the measure of 1 gram equals 1 cigarette, we apply it to the quantity of imports and find that approximately the equivalent of 167,156,413 packs of 20 would have been imported in 2011. At a rate of around €0.50 per pack, the excise would amount to approximately €83,578,207, which is actually fairly close to the reported 87,289,476. This also implies that the customs values a pack at an average of €0.34 on import for base value. If we take the number of packs of imported cigarettes as correct, then at the rate of about €2 for a pack, the total spending should have been €334,312,826, which is approximately 50 percent more than the amount reported in the household survey. If total domestic spending is actually correct, then it implies that a large portion of imports are actually not being consumed by households in Kosovo.

Table 3.15. Collections of Excises and Customs Duty on Tobacco 2011

Years	2011					
	Quantity kg.	Customs base value	Customs tariff	Excise	VAT	TOTAL
January	142,760.92	2,458,904.37	245,890.44	3,655,743.00	1,017,686.05	4,919,319.49
February	281,001.10	4,283,628.23	418,887.02	7,383,500.00	1,933,762.44	9,736,149.46
March	288,565.33	4,200,900.19	411,261.22	7,393,526.00	1,920,909.99	9,725,697.20
April	172,337.61	2,754,704.81	254,826.53	4,467,189.00	1,196,275.25	5,918,290.79
May	268,662.42	3,927,506.20	373,146.62	7,148,975.00	1,831,940.45	9,354,062.07
June	199,208.38	3,306,946.08	313,345.51	4,956,993.00	1,372,365.53	6,642,704.04
July	275,801.13	4,774,626.42	448,802.04	7,218,790.00	1,990,754.95	9,658,347.00
August	276,404.98	5,282,156.53	509,416.05	7,258,091.00	2,087,946.17	9,855,453.23
September	390,939.92	6,760,710.67	657,206.97	10,178,225.00	2,815,382.82	13,650,814.79
October	227,049.41	4,441,472.40	425,324.74	6,240,625.00	1,777,187.54	8,443,137.28
November	280,700.76	5,581,461.36	529,832.94	7,535,944.00	2,183,558.13	10,249,335.06
December	539,696.30	9,293,982.89	891,751.64	13,851,875.00	3,846,017.52	18,589,644.16
Total	3,343,128.26	57,067,000.15	5,479,691.72	87,289,476.00	23,973,786.86	116,742,954.57

Source: Customs Agency.

3.25. The results hold also for VAT on cigarettes. It is not clear whether these figures include domestic production as this excise is also collected by customs. Table 3.15 represents imports and not include domestic production as we were informed. As a check we apply the rate of €25 per kg to the import weight above and get the same result for excise as if we had converted to packs – the rate actually charged is approximately €26.11 per kg on the import figures reported above. Even if we take a conservative estimate of 1.2 grams per cigarette, and we assume that weight of tobacco reported equals the weight of cigarettes, we still find that 139,297,011 packs must have been imported that sold at around €278,594,022 in the market at €2 per pack. If we instead take the tobacco weight of 0.9 grams a cigarette and the weight imported as weight of tobacco only, we get more packs than 167 million, a lower average customs base value per pack and an even greater discrepancy with the HBS figures. Either way we cannot report a tax gap with the HBS figures. We can only say that at 16 percent VAT, VAT collected on spending of €210 million on tobacco and cigarettes reported in HBS 2011 should be around €30 million in the same year (from both customs VAT at border and domestic net VAT together).

3.26. The conclusion is inescapable: either the household consumption is severely under-reported, or a very large part of imports plus domestic production is being diverted (possible after payment of duty and VAT) to other countries, where prices are higher. Kosovo is probably gaining revenue due to this. It is worth cautioning that most household surveys around the world find under reporting for “sin” goods and it may be the case that this is so for Kosovo as well.

Alcohol

3.27. Estimating the tax gap from sales of alcohol has suffered from data availability. The HBS reports total household spending on beer at €25,461,865 in 2011. Customs reports imports

of beer in 2011 at €7,922,715 base value and total taxes on beer at €5,499,578, adding to a total of about €13,422,294 or a little more than half of expenditure. However, there is domestic production and tax collection on beer and unless we know the quantity, value and domestic tax collection we are not in a position to estimate on the size of the gap.

3.28. Similarly the HBS 2011 reports spending of €7,513,445 on spirits and €7,273,620 on wine. We only have customs information on “alcohol” and we do not know if this includes both. The total value of alcohol imports reported in 2011 is €3,103,924 on which total taxes were €2,276,975, which adds up to € 5,380,899. If this pertains to spirits only, we will find almost no gap with the HBS once we add in wholesale and retail margins, transport, marketing and distribution costs and the extra VAT on those with imported figures alone. Again, this does not include the possibility of domestic production. We have no data on wine – either imports or domestic production.

3.29. **However, we can estimate the tax base from data provided, which could be compared with actual tax collection.** From HBS 2011, total spending on all categories of alcohol is around €40 million. VAT on this alone (border plus net domestic) should be around €5.5 million and if we apply the same ratio of excise to VAT as found in the customs data (1.72) to this VAT, excise collections should be at least €9.5 million. This can be compared with the actual data was not attainable for this report.

G. SUMMARY

3.30. The technical chapter has estimated the tax gap for VAT, PIT and CIT as follows:

- The total VAT was estimated using information provided by the national accounts agency for 2011 household consumption expenditures based on the household survey, information on expenditures split into consumption and gross capital formation and total expenditures of nonprofit institutions serving households (NPISH). The consumption approach was used. National accounts also provided a supply and use table for 2005-06 (at “current” prices) as well files for turnover of firms below the €50,000 threshold to facilitate this estimation.
- Using this data, the estimated VAT potential in 2011 was €718,893,733 - as compared to the actual receipts reported for 2011 of €536,453,103. Thus the estimated VAT gap in 2011 is approximately 34 percent of the present collection.
- For the PIT, data was provided by the authorities from the household budget survey on estimated total incomes. Applying the income tax law to the available income, we get an estimate of the potential PIT at €53,431,866 out of total income estimated at €1,368,786,249. The tax collected is estimated at 3.9 percent of income. This can be compared to actual collection in 2011 from withholding of PIT at €55,668,304 and the potential comes to almost the same amount as tax collected.
- However, the figures above are obviously not reliable since total household consumption from the same survey used for VAT calculations shows that household consumption is €4,428,203,299 or about 3.25 times the estimated income. Even if the PIT law had been applied directly to the consumption and not income, the

estimated tax potential would have been about 3.5 times higher than estimated at present.

- Using data on audit of firms to estimate the potential from CIT, we find that using baseline assumptions on the probability of evasion of non-audited firms, the CIT potential is around 17 percent of present collection in 2012. The range for this proportion using ranges of probability of evasion for the total sample between 20 and 53 percent for large and LTU firms and between 33 and 66 percent for other firms gives us a range of potential tax gap for CIT of 12 to 27 percent of actual collections in that year.

3.31. In addition, the overall size of the shadow economy was estimated:

- The use of the overall model of evasion based on currency demand (the Tanzi Model) shows that overall evasion based on the estimated size of the underground economy during 2004-2011 was between 7.5 and 18.8 percent.

3.32. Finally, efforts were made to estimate the tax gap for some specific sin taxes:

- Data from the HBS was also used to estimate the gap on account of tobacco (cigarettes). Under various assumptions, the amount of consumption based on the household survey and the amount of tax collections turn out to be lower than present collections. Either the household consumption is severely under-reported, or a very large part of imports plus domestic production is being diverted (possibly after payment of duty and VAT) to other countries where prices are higher.
- From the 2011 household survey, total spending on all categories of alcohol is around €40 million. VAT on this alone (border plus net domestic) should be around €5.5 million and if we apply the same ratio of excise to VAT as found in the customs data (1.72) to this VAT, excise collections should be at least €9.5 million. This can be compared with the actual data on collections, which we do not have.

APPENDIX I.

Table 1. Tax Ratios: 2005-2010 with Kosovo

SNo	Country	Region	Income	Shadow	Tax/ GDP		Tax potential		Differ ence	Tax space with shadow (% of GDP)	Tax gap with shadow (% of GDP)	Tax effort without shadow		Tax effort with shadow	
					Without shadow	With shadow	Economic	Legal				Economic	Legal	Economic	Legal
1	Albania	ECA	UMIC	33.30	23.43	17.58	26.04	26.67	0.63	8.46	9.09	0.90	0.88	0.68	0.66
2	Argentina	LAC	UMIC	23.83	29.12	23.51	25.28	29.60	4.32	1.77	6.09	1.15	0.98	0.93	0.79
3	Armenia	ECA	LMIC	41.97	19.33	13.62	19.52	22.00	2.48	5.90	8.38	0.99	0.88	0.70	0.62
4	Austria	OECD	HIC	9.63	42.10	38.40	37.89	38.62	0.72	-0.51	0.22	1.11	1.09	1.01	0.99
5	Azerbaijan	ECA	UMIC	54.23	18.67	12.10	20.60	22.51	1.91	8.49	10.40	0.91	0.83	0.59	0.54
6	Belarus	ECA	UMIC	44.23	44.57	30.90	27.83	30.51	2.68	-3.07	-0.39	1.60	1.46	1.11	1.01
7	Belgium	OECD	HIC	21.50	44.10	36.30	40.11	43.59	3.47	3.82	7.29	1.10	1.01	0.90	0.83
8	Bosnia and	ECA	UMIC	32.97	37.57	28.25	29.73	28.95	-0.78	1.48	0.69	1.26	1.30	0.95	0.98
9	Brazil	LAC	UMIC	37.60	33.05	24.02	27.02	29.11	2.09	3.00	5.10	1.22	1.14	0.89	0.82
10	Bulgaria	ECA	UMIC	33.43	30.45	22.82	31.54	31.39	-0.15	8.72	8.57	0.97	0.97	0.72	0.73
11	Canada	OECD	HIC	15.37	32.47	28.15	36.45	28.43	-8.01	8.30	0.29	0.89	1.14	0.77	0.99
12	Chile	LAC	UMIC	18.70	21.93	18.47	30.03	29.13	-0.90	11.56	10.66	0.73	0.75	0.62	0.63
13	Colombia	LAC	UMIC	34.90	17.83	13.22	23.91	24.89	0.98	10.70	11.67	0.75	0.72	0.55	0.53
14	Croatia	ECA	HIC	30.83	34.25	26.18	31.84	34.25	2.41	5.66	8.07	1.08	1.00	0.82	0.76
15	Czech Repu	ECA	HIC	17.37	34.48	29.38	34.71	36.04	1.33	5.33	6.66	0.99	0.96	0.85	0.82
16	Denmark	OECD	HIC	17.17	48.73	41.59	38.64	43.09	4.44	-2.95	1.49	1.26	1.13	1.08	0.97
17	El Salvador	LAC	LMIC	43.77	14.77	10.28	22.12	17.35	-4.77	11.84	7.07	0.67	0.85	0.46	0.59
18	Estonia	OECD	HIC	29.93	32.17	24.76	35.64	35.87	0.23	10.89	11.11	0.90	0.90	0.69	0.69
19	Finland	OECD	HIC	17.17	43.05	36.74	35.96	38.28	2.32	-0.78	1.54	1.20	1.12	1.02	0.96
20	France	OECD	HIC	14.77	43.17	37.61	35.73	37.41	1.68	-1.88	-0.20	1.21	1.15	1.05	1.01
21	Georgia	ECA	LMIC	63.60	23.70	14.49	27.41	27.74	0.33	12.92	13.25	0.86	0.85	0.53	0.52
22	Germany	OECD	HIC	15.63	38.63	33.41	36.33	37.23	0.90	2.92	3.82	1.06	1.04	0.92	0.90
23	Greece	OECD	HIC	26.60	31.70	25.04	34.72	36.28	1.56	9.68	11.24	0.91	0.87	0.72	0.69
24	Hungary	OECD	HIC	23.80	38.70	31.26	35.59	37.45	1.87	4.33	6.19	1.09	1.03	0.88	0.83
25	Indonesia	EAP	LMIC	18.27	17.28	14.61	17.23	14.26	-2.97	2.62	-0.35	1.00	1.21	0.85	1.02
26	Ireland	OECD	HIC	15.50	29.97	25.95	39.52	38.21	-1.31	13.57	12.26	0.76	0.78	0.66	0.68
27	Italy	OECD	HIC	26.93	42.05	33.13	32.76	35.54	2.78	-0.36	2.42	1.28	1.18	1.01	0.93
28	Japan	OECD	HIC	10.47	27.79	25.16	33.11	24.24	-8.87	7.95	-0.92	0.84	1.15	0.76	1.04
29	Kazakhstan	ECA	UMIC	39.03	25.40	18.27	26.08	24.61	-1.48	7.81	6.34	0.97	1.03	0.70	0.74
30	Korea, Rep.	OECD	HIC	25.93	25.44	20.20	33.99	28.92	-5.07	13.79	8.72	0.75	0.88	0.59	0.70
31	Kyrgyz Repu	ECA	LIC	39.57	21.92	15.70	19.83	20.67	0.83	4.13	4.96	1.11	1.06	0.79	0.76
32	Latvia	OECD	UMIC	27.77	28.60	22.38	34.48	33.69	-0.79	12.10	11.31	0.83	0.85	0.65	0.66
33	Lithuania	OECD	UMIC	30.37	28.97	22.22	33.63	33.25	-0.38	11.41	11.03	0.86	0.87	0.66	0.67
34	Macedonia	ECA	UMIC	35.93	27.25	20.05	29.81	28.71	-1.10	9.76	8.67	0.91	0.95	0.67	0.70
35	Malaysia	EAP	UMIC	30.00	21.56	16.58	28.07	22.52	-5.55	11.49	5.93	0.77	0.96	0.59	0.74
36	Mexico	LAC	UMIC	29.30	18.40	14.23	26.34	24.36	-1.98	12.11	10.13	0.70	0.76	0.54	0.58
37	Moldova	ECA	LMIC	43.85	33.03	22.96	29.45	29.19	-0.27	6.49	6.22	1.12	1.13	0.78	0.79
38	Montenegro	ECA	UMIC		38.05		31.88	28.51	-3.37			1.19	1.33		
39	Netherlands	OECD	HIC	13.13	38.60	34.12	40.68	41.01	0.34	6.56	6.89	0.95	0.94	0.84	0.83
40	Norway	OECD	HIC	18.23	42.83	36.23	34.11	38.32	4.21	-2.11	2.09	1.26	1.12	1.06	0.95
41	Peru	LAC	UMIC	55.53	16.87	10.85	23.21	24.42	1.21	12.36	13.57	0.73	0.69	0.47	0.44
42	Poland	ECA	HIC	26.43	33.13	26.21	32.85	36.02	3.17	6.65	9.82	1.01	0.92	0.80	0.73
43	Portugal	OECD	HIC	23.17	31.98	25.97	34.56	36.74	2.18	8.60	10.77	0.93	0.87	0.75	0.71
44	Romania	ECA	UMIC	30.87	28.43	21.73	29.16	29.96	0.80	7.43	8.23	0.98	0.95	0.75	0.73
45	Russian Fe	ECA	UMIC	41.57	31.07	21.94	28.52	29.73	1.21	6.58	7.79	1.09	1.04	0.77	0.74
46	Serbia	ECA	UMIC		37.43		28.19	25.72	-2.47			1.33	1.46		
47	Slovak Repu	ECA	HIC	17.20	29.23	24.94	35.78	37.10	1.31	10.84	12.15	0.82	0.79	0.70	0.67
48	Slovenia	OECD	HIC	25.27	37.93	30.28	36.50	38.01	1.51	6.22	7.73	1.04	1.00	0.83	0.80
49	South Africa	AFR	UMIC	25.90	30.25	24.03	27.71	27.36	-0.35	3.68	3.33	1.09	1.11	0.87	0.88
50	Spain	OECD	HIC	22.33	34.23	27.98	34.47	34.71	0.24	6.49	6.73	0.99	0.99	0.81	0.81
51	Sweden	OECD	HIC	18.23	47.23	39.95	37.35	41.91	4.55	-2.60	1.96	1.26	1.13	1.07	0.95
52	Switzerland	OECD	HIC	8.30	29.29	27.05	38.84	28.79	-10.05	11.79	1.74	0.75	1.02	0.70	0.94
53	Tajikistan	ECA	LIC	41.23	18.18	12.87	14.65	16.81	2.16	1.78	3.94	1.24	1.08	0.88	0.77
54	Thailand	EAP	UMIC	48.57	19.95	13.43	26.15	21.17	-4.98	12.72	7.75	0.76	0.94	0.51	0.63
55	Tunisia	MENA	UMIC	36.00	27.73	20.39	28.59	32.01	3.41	8.21	11.62	0.97	0.87	0.71	0.64
56	Turkey	ECA	UMIC	29.53	24.53	18.94	28.26	27.89	-0.37	9.32	8.95	0.87	0.88	0.67	0.68
57	Turkmenist	ECA	LMIC		19.12		20.15					0.95			
58	Ukraine	ECA	LMIC	47.30	36.20	24.58	26.71	30.88	4.17	2.13	6.30	1.36	1.17	0.92	0.80
59	United King	OECD	HIC	12.30	36.22	32.25	36.77	36.25	-0.52	4.52	4.00	0.98	1.00	0.88	0.89
60	Uruguay	LAC	UMIC	47.93	22.49	15.20	28.28	31.61	3.33	13.08	16.41	0.80	0.71	0.54	0.48
61	Venezuela	LAC	UMIC	32.13	15.62	11.82	20.20	17.16	-3.03	8.38	5.34	0.77	0.91	0.59	0.69
62	Kosovo	ECA	LMIC	39.00	25.13	18.08	26.74	23.53	-3.21	8.66	5.45	0.94	1.07	0.68	0.77

APPENDIX II. THE POTI QUESTIONNAIRE

Perceptions of Tax Implementation in Kosovo
June 2013

INDEXKOSOVA



M-1. Respondent identification number _ _ _ _ _

M-2. Company size 1. Middle 2. Large

M-3. Month of interview

- | | | |
|-------------|-----------|--------------|
| 1. January | 5. May | 9. September |
| 2. February | 6. June | 10. October |
| 3. March | 7. July | 11. November |
| 4. April | 8. August | 12. December |

M-4. Date of interview _ _ _ _

M-5. Day of Week Interview Completed:

- | | |
|--------------|-------------|
| 1. Sunday | 5. Thursday |
| 2. Monday | 6. Friday |
| 3. Tuesday | 7. Saturday |
| 4. Wednesday | |

M-6. Region

- | | | | |
|--------------|-------------|------------|------------|
| 1. Prishtina | 3. Prizreni | 5. Gjilani | 7. Ferizaj |
| 2. Mitrovica | 4. Gjakova | 6. Peja | |

M-7. Urban/Rural Residence

-
- | | | | |
|---------------|------------|--------------|--------------|
| 1. Rural area | 2. Village | 3. Town/City | 4. Prishtina |
|---------------|------------|--------------|--------------|

M-9. Interviewer Code: _ _ _ _ _

M-10. Interview completed on...

1. First Visit?
2. Second Visit?
3. Third Visit?

M-11. Supervisor Code: _ _ _ _ _

M-12. Record time (using 24 hour clock) Interview was Started: __ __ : __ __

(Write down the beginning time starting from question P-1. Fill in all four data positions)

M-13. Record Time (using 24 hour clock) Interview was Completed: __ __ : __ __

(Fill in all four data positions)

M-14. Record Length of Interview in Minutes: ____ ____

(When record time is greater than 99 minutes write as 99)

M-15. Key-Puncher Code: __ __ __ __

A Survey of

Perceptions of Tax Implementation in Kosovo

Introductory text:

This short survey is being carried out by the World Bank to help us understand better how the tax system is implemented in Kosovo. The survey will only take around 15 minutes of your time and we appreciate hearing your views. Please rest assured that all of your responses will be treated with utmost confidentiality and results will be presented only in aggregate.

If you would like to receive a copy of the results, we would be happy to share them with you. Please provide an email address to which we can send the short report.

I will first ask you a few questions about yourself and your firm and then some of your thoughts on the tax system.

A) About you

A.1 Gender...

1. male	2. female
---------	-----------

Circle one
option

A.2 What is your age category?

1. 18-25	2. 26-35	3. 36-55	4. 55+
----------	----------	----------	--------

Circle one
option

A.3 What is the highest level of education you have achieved?

1. Primary	2. Secondary	3. High School	4. University	5. Masters / PhD
------------	--------------	----------------	---------------	------------------

Circle one
option

A.4 What is your position within your firm?

1. Accountant/ Finance Manager	2. Director / CEO	3. Owner	4. Other (specify):
--------------------------------------	----------------------	----------	------------------------------

Circle one
option

B) About your firm

B.1 In what year did your firm begin operating in Kosovo?
Insert year (e.g. 2006)

B.2 How many people work (part- or full-time) for your firm in Kosovo?

1 - 5	1
6 - 19	2
20 - 99	3
100 - 999	4
>1000	5

Circle one option

B.3 In which municipality of Kosovo is your firm's headquarters?

1	Decan	14	Klina	27	Pristina
2	Dragash	15	Klokot	28	Prizren
3	Ferizaj	16	Leposaviq	29	Rahovec
4	FusheKosove	17	Lipjan	30	Ranilug
5	Gjakova	18	Malisheve	31	Shterpce
6	Gjilan	19	Mamush	32	Skenderaj
7	Glogovac	20	Mitrovica	33	Stimlje
8	Gracanice	21	MNAO	34	Suva Reka
9	Hani i Elezit	22	Novo Brdo	35	Viti
10	Istog	23	Obilic	36	Vushtrri
11	Junik	24	Partesh	37	ZubinPotok
12	Kacanik	25	Peja	38	Zvecan
13	Kamenica	26	Podujevo		

Circle one option

B.4 What is the main sector your firm operates in (the one that brings in the most revenue)?

Manufacturing	Food	1
	Textiles	2
	Garments	3
	Chemicals	4
	Plastics & rubber	5
	Non-metallic mineral products	6
	Basic metals	7

Services	Construction - production of construction materials	8
	Tobacco production	9
	Fabricated metal products	10
	Machinery and equipment	11
	Electronics	12
	Other manufacturing (specify)	13
	<i>Specify:</i>	
	Wholesale	14
	Retail (non-fuel)	15
	Gas stations/gas distribution	16
	IT	17
	Hotels and restaurants	18
	Construction of buildings or infrastructure	19
	Tobacco trade	20

Circle one option

B.5 What is the ownership status of your firm?

Company listed on a stock exchange	1
Privately held, limited liability company (SPK)	2
Sole proprietorship	3
Partnership	4
Limited partnership	5
Other (specify):	

Circle one option

B.6

Are any of the firm owners female?	1. Yes No	2.
------------------------------------	--------------	----

Circle one option

B.7

Do any of the following own a share of the firm?

Private domestic individuals, companies or organizations	1. Yes No	2.
Private foreign individuals, companies or organizations	1. Yes No	2.
Government/State/Local government	1. Yes	2.

	No
--	----

Circle Yes or No for each option

B.8

Does your firm import any goods or services?	1. Yes No	2.
--	--------------	----

Circle Yes or No for each option

B.9

Does your firm export any goods or services?	1. Yes No	2.
--	--------------	----

Circle Yes or No for each option

C) Tax compliance and implementation

I would now like to ask you some questions about companies' VAT and CIT payment practices.

C.1 What proportion of firms like yours (similar size and sector) would you say declare less than they should to the tax office for **VAT and CIT taxes**?

	None	1-25%	26-50%	>50%
a. VAT	0	1	2	3
b. CIT	0	1	2	3

Select one option for VAT and one option for CIT

C.2 For firms like yours, what percentage of the legal value was undeclared to the tax office last year for **VAT and CIT taxes**?

a. VAT%
b. CIT%

Complete % for VAT and CIT

C.3 For firms like yours, what percentage of total employees is unreported to the tax office?

0. None	1. 1-25%	2. 26-50%	3. >50%
---------	----------	-----------	---------

C.4 For firms like yours, what percentage of employees earns more than is reported to the tax office?

0. None	1. 1-25%	2. 26-50%	3. >50%
---------	----------	-----------	---------

C.5 Corporate income tax in Kosovo, *as it is written*, how progressive or regressive do you think it is?

Progressive (those with larger profits should pay a larger share)	Neutral (those with larger profits should pay the same share)	Regressive (those with larger profits should pay a smaller share)
1	2	3

C.6 Corporate income tax in Kosovo, *as it is actually practiced*, how progressive or regressive do you think it is?

Progressive (those with larger profits actually pay a larger share)	Neutral (those with larger profits actually pay the same share)	Regressive (those with larger profits pay actually a smaller share)
1	2	3

D) Enforcement of the tax rules

Now I would like to ask you some questions about how you perceive the enforcement of tax rules when firms do not pay the tax that they are supposed to by law.

D.1 Sometimes firms illegally attempt to evade some of the tax they owe. Which type of firm do you think is more successful in evading some of their taxes?

	More successful	Average	Less successful
(a) Firms whose owner knows a cabinet member	1	2	3
(b) Firms whose owner has personal friends in TAK	1	2	3
(c) Firms with a politician as the owner or one of the owners	1	2	3

Circle one option for each

D.2 Sometimes firms get penalties for not paying tax. Which type of firm do you think is more successful in escaping the penalties?

	More successful	Average	Less successful
(a) Firms whose owner knows a cabinet member	1	2	3
(b) Firms whose owner has personal friends in TAK	1	2	3

(c) Firms with a politician as the owner or one of the owners	1	2	3
---	---	---	---

Circle one option for each

D.3 Which sized firm do you think is more successful in...

	Firms with less than €200,000 turnover per year	Firms with between €200,000 and €1 million turnover per year	Firms with over €1 million turnover per year
evading some of their tax?	1	2	3
in escaping the penalties?	1	2	3

D.4 If a firm wished to avoid a severe penalty for tax avoidance, which **one** of the following would be the most helpful? (*select only one option*)

An owner or top-level manager who knows a cabinet member	1
An owner or top-level manager who has personal friends in TAK	2
At least one of the owners is a politician	3

Choose only one option

D.5 Are there any other factors that would make it easier for a firm to avoid paying tax?
Please list below:

- 1.....
- 2.....
- 3.....

E) Quality of provision of tax services

E.1 To what extent do you agree or disagree with the following statements:

(a) The tax office is doing a good job in providing services to your business

Agree	Mostly agree	Neither agree nor disagree	Mostly disagree	Disagree	Don't know
1	2	3	4	5	9

(b) There are many benefits for business that pay taxes

Agree	Mostly agree	Neither agree nor disagree	Mostly disagree	Disagree	Don't know
1	2	3	4	5	9

(c) The same rules applied to all firms audited

Agree	Mostly agree	Neither agree nor disagree	Mostly disagree	Disagree	Don't know
1	2	3	4	5	9

(d) Every business should pay taxes

Agree	Mostly agree	Neither agree nor disagree	Mostly disagree	Disagree	Don't know
1	2	3	4	5	9

(e) Most businesses do pay taxes

Agree	Mostly agree	Neither agree nor disagree	Mostly disagree	Disagree	Don't know
1	2	3	4	5	9

(f) Tax legislation is sufficiently clear and precise to be easily understood by taxpayers and to avoid legal ambiguities in its application

Agree	Mostly agree	Neither agree nor disagree	Mostly disagree	Disagree	Don't know
1	2	3	4	5	9

(g) Tax procedures are clear and simple

Agree	Mostly agree	Neither agree nor disagree	Mostly disagree	Disagree	Don't know
1	2	3	4	5	9

(h) All information I need about tax compliance is easily available

Agree	Mostly agree	Neither agree nor disagree	Mostly disagree	Disagree	Don't know
1	2	3	4	5	9

(i) Tax officials are corrupt

Agree	Mostly agree	Neither agree nor disagree	Mostly disagree	Disagree	Don't know
1	2	3	4	5	9

F) Government procurement contracts

F.1 Has your firm bid for a contract to supply the government with goods or services in the last two years?

1. Yes 2. No
(If 'yes', go to F.2. If no, go to F.4)

F.2 Has your firm won contracts to supply the government with goods or services in the last two years?

1. Yes 2. No

F.3 Are you aware of any illegal (such as bribery) or non-competitive (such as seeking to influence a friend) practices applied by rival bidders to increase their chances of winning government contracts?

- (a) Illegal: 1. Yes 2. No
 (b) Non-competitive: 1. Yes 2. No

F.4 In your sector, how often do firms bidding for government contracts engage in the following behaviors with the aim to increase their chances of winning government contracts:

(a) Bribery of low-level public officials

Never			Almost Always		Don't know	No response
1	2	3	4	5	8	9

(b) Donations or contributions to high-ranking politicians

Never			Almost Always		Don't know	No response
1	2	3	4	5	8	9

(c) Exchanging favors

Never			Almost Always		Don't know	No response
1	2	3	4	5	8	9

(d) Use of personal contacts

Never			Almost Always		Don't know	No response
1	2	3	4	5	8	9

Read Closing Statement
to the Respondent:

"Thank you for participating in our survey. Do you have any questions? In the next few days my supervisor may contact you to evaluate the quality of my work and answer any other questions you may have about the interview. To help him do that, could I have your telephone number?"

Respondent Information:

Name: _____

Address: _____

Tel No. _____

Id No. ____ _

Interviewer Certification:

"I certify that I have completed this interview according to the instructions provided to me by INDEX KOSOVA."

Name: _____

Signature: _____

Date: _____

To be completed by the Supervisor:

M-16. Interview Subject to control/back-check

1. Yes
2. No

M-17. Method of Control/Back-check

1. Direct supervision during interview
2. Control of person by supervisor
3. Control through telephone by supervisor or Index Kosova
4. Not Subject to control

APPENDIX III. ESTIMATING THE COST OF TAX EVASION

We use the following methodology and calculations to estimate the cost of tax evasion for the Large Taxpayer's Unit for VAT and CIT:

Total cost of evasion = Number of evaders * Average loss

Where:

* No. evaders = % evading* No. firms in LTU

And:

* Average loss = Average correct tax- average actual tax

Where:

* Average correct tax= Average actual tax/(1- % evasion)

* Since: Average actual tax= Correct tax - amount evaded = Correct tax*(1-%evasion)

* So: Average correct tax=Average actual tax/(1-%evasion)

* Giving: Average loss = {Average actual tax/(1-%evasion)} - {average actual tax}

So:

Total cost of evasion = {No. evaders}* {Average loss} = {% evading* No. firms in LTU} * {[Average actual tax/(1-%evasion)] - [average actual tax]}

We use the following methodology and calculations to estimate the cost of tax evasion for “missing workers” for the formal sector:

1. Take total private sector workers in VAT registered firms.

2. Estimate correct number of workers

* Correct number = reported number/ (1-under-reporting %)

3. Calculate the number of 'missing workers'

* Correct number - reported number

4. Estimate average annual pre-tax earnings (monthly earnings from TAK* 12)

5. Estimate average tax rate

* Use weighted household survey to get population in each tax bracket.

* Calculate tax per person in each bracket using mean income for each bracket

* Calculate total tax in each bracket by multiplying tax per person by population then sum to get total tax.

* Calculate total income using mean income by class and population numbers.

* Divide total tax by total income to get an average tax rate of 4.2%

6. Estimate missing tax revenues from missing workers

* Number of missing workers* Average annual earnings* average tax rate

APPENDIX IV. DESCRIPTIVE STATISTICS AND REGRESSION MODELS

Table 1. Definitions of Variables Used in the Econometric Analysis and Share of the Whole Sample

Variable	Definition	Share in the whole sample
Medium	Medium size firm	44.8
Female_owner	With at least one female owner	18.2
Prishtina	In Prishtina region	56.9
Service	Firm operates mainly in service sector	60.8
LLC	Limited Liability Company	27.1
Construction	Operation in construction sector	16.6
Importer	Import service or goods	66.3
Exporter	Export service or goods	36.5
Newer_firm	Firms started to operation in Kosovo since 2000	70.4
More_employee	With 20 or more (full-time/part time) employees	46.4
Female_respondent	Female respondent	9.4
Accountant	Respondent's position in the firm is account	36.5
Higher_educ	Respondent received high school or higher education	64.6
Age_younger	Respondent's age is below 36	34.3
Number of Observations	Number of Observations	181

Source: Computed from the survey data.

Table 2. Regression Analysis on Overall Refusals

Variable	% questions skipped
Medium	-0.011 (0.023)
Female_owner	0.055* (0.029)
Prishtina	-0.033 (0.020)
Service	0.020 (0.021)
LLC	0.008 (0.027)
Construction	-0.026 (0.025)
Importer	0.004 (0.023)
Exporter	-0.024 (0.022)
Newer_firm	-0.053** (0.022)
More_employee	-0.011 (0.025)
Female_respondent	-0.007 (0.042)
Accountant	-0.004 (0.020)
Higher_educ	0.028 (0.020)
Age_younger	0.007 (0.021)
Prob > F	0.2682
R-squared	0.1005
Number of Observations	177

Note. The dependent variables is the ratio of the number of questions each respondent skipped over total number of questions from section C to section F(35 in total); results are from a OLS regression model; robust standard errors are in parentheses; 4 observations were dropped during analysis due to missing values; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 3. Descriptive statistics of Firms and Respondents in the Survey

Sampling		About the firm	
Company size		Employees	
Medium	81	1 -5	21.0
Large Tax Unit (LTU)	100	6 - 19	32.6
Region		20 - 99	30.9
Prishtina	56.9	100 - 999	14.9
Mitrovica	3.9	>1000	0.6
Prizreni	7.2	Ownership	
Gjakova	5.5	Company listed on a stock exchange	0.6
Gjilani	5.5	Privately held, limited liability company	22.1
Peja	9.4	Sole proprietorship	58.0
Ferizaj	11.6	Partnership	12.7
About the respondent		Limited partnership	4.4
Female		Others	2.2
Age		Female ownership	18.2
18-25	6.1	Share owned	
26-35	28.2	Private, domestic, individuals companies or organization	85.6
36-55	55.3	Private, foreign, individuals companies or organization	5.0
55+	10.5	Government/state/local government	2.8
Education		Importer	66.3
Primary	0.6	Exporter	36.5
Secondary	33.7	Sector	
High School	7.2	Manufacturing	39.2
University	47.5	Service	60.8
Masters/Phd	9.9	Company operation year	
Position		Before 1990	7.8
Accountant/ finance manager	36.5	1990-1999	21.8
Director / ceo	20.4	After 1999	70.4
Owner	34.8		
Other	8.3		

Source: Computed from the survey data.

Note. Numbers about company size are in absolute number; other numbers in this table are reported in percentage

Table 4. Regression analysis on firms' characteristics

	Medium		Female_o wner		prishtina		service		LLC		constructio n		importer		Exporter		Newer_firm Newer_firm
female_ow ner	0.450	medium	0.438	medium	-0.721**	medium	-0.692**	medium	-0.432	medium	-0.027	medium	-0.458	medium	-0.854***	medium	0.484*
	(0.325)		(0.325)		(0.281)		(0.288)		(0.295)		(0.315)		(0.294)		(0.263)		(0.285)
female_res pondent	-0.181	female_resp ondent	-0.260	female_o wner	0.561**	female_own er	-0.011	female_ow ner	0.212	female_o wner	-0.427	female_ow ner	0.186	female_o wner	0.072	female_ow ner	-0.392
	(0.465)		(0.439)		(0.272)		(0.262)		(0.300)		(0.337)		(0.295)		(0.271)		(0.271)
prishtina	-0.694**	prishtina	0.516**	female_re spondent	0.704*	female_resp ondent	-0.129	female_res pondent	0.401	female_re spondent	0.383	female_res pondent	0.898*	female_r esponde nt	-0.226	female_res pondent	0.059
	(0.271)		(0.260)		(0.378)		(0.390)		(0.362)		(0.436)		(0.545)		(0.391)		(0.408)
service	-0.775***	service	-0.005	service	-0.058	prishtina	-0.074	prishtina	-0.113	prishtina	-0.378	prishtina	-0.145	prishtina	-0.052	prishtina	0.427
	(0.283)		(0.246)		(0.234)		(0.238)		(0.263)		(0.296)		(0.253)		(0.237)		(0.260)
LLC	-0.411	LLC	0.212	LLC	-0.121	LLC	-0.255	service	-0.246	service	-0.137	service	-0.419*	service	-0.817***	service	0.422*
	(0.272)		(0.282)		(0.262)		(0.237)		(0.228)		(0.254)		(0.232)		(0.218)		(0.233)
accountant	-0.376	accountant	0.272	accounta nt	0.214	accountant	-0.294	accountant	0.420*	LLC	0.603**	LLC	0.099	LLC	-0.044	LLC	-0.101
	(0.267)		(0.257)		(0.228)		(0.225)		(0.240)		(0.274)		(0.270)		(0.255)		(0.253)
importer	-0.459*	importer	0.204	importer	-0.161	importer	-0.399*	importer	0.078	accountan t	-0.390	accountan t	0.036	accounta nt	-0.030	accountan t	0.471**
	(0.278)		(0.281)		(0.251)		(0.240)		(0.270)		(0.258)		(0.241)		(0.237)		(0.233)
exporter	-0.916***	exporter	0.045	exporter	-0.070	exporter	-0.801***	exporter	-0.001	importer	0.582**	exporter	0.541**	importer	0.556**	importer	-0.432*
	(0.256)		(0.260)		(0.234)		(0.224)		(0.247)		(0.286)		(0.244)		(0.250)		(0.256)
Newer_fir mNewer_fi rm	0.432	Newer_firm Newer_firm	-0.408	Newer_fir mNewer_ firm	0.418	Newer_firm Newer_firm	0.396*	Newer_fir mNewer_fi rm	-0.150	exporter	0.123	Newer_fir mNewer_fi rm	-0.440*	Newer_fi rmNewer_ firm	-0.318	exporter	-0.271
	(0.268)		(0.265)		(0.270)		(0.238)		(0.262)		(0.276)		(0.264)		(0.242)		(0.242)
higher_edu c	-0.432	higher_educ	0.030	higher_ed uc	0.216	higher_educ	-0.049	higher_edu c	0.675***	Newer_fir mNewer_f irm	0.587**	higher_edu c	0.048	higher_e duc	-0.025	higher_edu c	0.605**
	(0.273)		(0.289)		(0.246)		(0.239)		(0.254)		(0.275)		(0.250)		(0.256)		(0.255)
more_empl oyee	-1.523***	more_emplo yee	0.454	more_em ployee	-0.602**	more_emplo yee	-0.058	more_empl oyee	0.017	higher_ed uc	-0.823***	more_empl oyee	0.174	more_em ployee	-0.144	more_emp loyee	-0.340
	(0.273)		(0.280)		(0.266)		(0.271)		(0.274)		(0.273)		(0.273)		(0.258)		(0.265)
age_young er	0.677**	age_younger	0.255	age_you nger	0.103	age_younger	0.250	age_young er	-0.008	more_emp loyee	0.437	age_young er	0.259	age_you nger	0.450*	age_young er	0.226
	(0.277)		(0.260)		(0.241)		(0.233)		(0.258)		(0.286)		(0.259)		(0.248)		(0.254)
constructio n	0.0343	construction	-0.356	construct ion	-0.457	construction	-0.239	constructio n	0.570**	age_young er	-0.133	constructi on	0.544*	construc tion	0.094	constructi on	0.630*
	(0.300)		(0.349)		(0.343)		(0.291)		(0.279)		(0.278)		(0.314)		(0.312)		(0.340)
Observatio ns	177	Observation	177	Observati ons	177	Observation	177	Observatio ns	177	Observati ons	177	Observatio ns	177	Observat ions	177	Observatio ns	177

Note. The dependent variables are all binary variables reported at the top of each regression result column; all the results are results of a series of probit regression analysis; robust standard errors are in parentheses; 4 observations were dropped during analysis due to missing values; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 5. Regression Analysis on VAT evasion (c1a: what proportion of firms like yours (similar size and sector) would you declare less than they should to the tax office of VAT tax?)

Variable	Whole Sample	LTU
Medium	-0.155 (0.311)	--
Female_owner	-0.543* (0.309)	-0.282 (0.448)
Prishtina	-0.080 (0.272)	-0.321 (0.406)
Service	0.160 (0.265)	0.531 (0.414)
LLC	0.067 (0.302)	0.270 (0.394)
Construction	-0.279 (0.337)	0.215 (0.484)
Importer	-0.009 (0.292)	-0.877 (0.559)
Exporter	0.077 (0.286)	0.932** (0.440)
Newer_firm	-0.116 (0.296)	-0.175 (0.479)
More_employee	-0.479 (0.297)	-1.707*** (0.571)
Female_respondent	0.145 (0.447)	0.853 (0.553)
Accountant	0.094 (0.284)	0.521 (0.391)
Higher_educ	-0.000 (0.302)	-0.300 (0.504)
Age_younger	0.324 (0.264)	0.163 (0.404)
Prob > chi2	0.557	0.1036
Pseudo R2	0.064	0.2266
Number of Observations	130	73

Note. The dependent variable is a binary variable, which equals to 1 if respondents gave an estimate fall into “1-100%”; results are form a probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 6. Regression Analysis on VAT evasion refusal (c1a: what proportion of firms like yours (similar size and sector) would you declare less than they should to the tax office of VAT tax?)

Variable	Whole sample	LTU
Medium	0.026 (0.295)	--
Female_owner	-0.347 (0.292)	-1.087** (0.455)
Prishtina	-0.259 (0.234)	-0.662** (0.336)
Service	0.047 (0.223)	0.446 (0.331)
LLC	-0.314 (0.261)	-0.552* (0.335)
Construction	-0.086 (0.301)	-0.351 (0.445)
Importer	-0.192 (0.247)	0.042 (0.389)
Exporter	0.011 (0.233)	0.087 (0.327)
Newer_firm	-0.463* (0.241)	-0.478 (0.338)
More_employee	-0.221 (0.289)	-0.272 (0.379)
Female_respondent	-0.032 (0.412)	-0.501 (0.565)
Accountant	0.334 (0.223)	0.139 (0.300)
Higher_educ	0.403 (0.274)	0.570 (0.432)
Age_younger	-0.240 (0.241)	-0.413 (0.367)
Prob > chi2	0.616	0.069
Pseudo R2	0.062	0.171
Number of Observations	177	99

Note. The dependent variable is binary variables, which equals to 1 if respondents gave “ref/no answer”; results are from probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 7. Regression Analysis on VAT evasion (c2a: for firms like yours, what percentage of the legal value was undeclared to the tax office last year for VAT tax?)

Variable	Whole Sample	LTU
Medium	-0.100 (0.361)	--
Female_owner	-0.250 (0.400)	-0.883 (0.698)
Prishtina	-0.168 (0.319)	-0.885 (0.548)
Service	0.332 (0.317)	0.522 (0.481)
LLC	0.052 (0.396)	0.502 (0.485)
Construction	0.329 (0.429)	-0.472 (0.542)
Importer	-0.110 (0.330)	-0.740 (0.624)
Exporter	0.105 (0.378)	0.211 (0.492)
Newer_firm	0.012 (0.388)	-0.466 (0.670)
More_employee	0.245 (0.347)	-0.869 (0.659)
Female_respondent	-0.782 (0.509)	-0.557 (0.642)
Accountant	0.006 (0.346)	0.879* (0.475)
Higher_educ	0.045 (0.350)	-0.334 (0.726)
Age_younger	0.192 (0.334)	-0.476 (0.630)
Prob > chi2	0.9696	0.4541
Pseudo R2	0.0511	0.2068
Number of Observations	88	46

Note. The dependent variable is a binary variable, which equals to 1 if respondents gave an estimate fall into “1-100%”; results are from a probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 8. Regression Analysis on VAT evasion refusal (c2a: for firms like yours, what percentage of the legal value was undeclared to the tax office last year for VAT tax?)

Variable	Whole sample	LTU
Medium	-0.159 (0.270)	--
Female_owner	0.037 (0.267)	-0.072 (0.373)
Prishtina	-0.172 (0.229)	-0.292 (0.300)
Service	-0.013 (0.219)	0.314 (0.295)
LLC	-0.398 (0.243)	-0.313 (0.284)
Construction	0.044 (0.275)	-0.215 (0.366)
Importer	0.204 (0.226)	0.456 (0.349)
Exporter	0.057 (0.226)	0.0663 (0.296)
Newer_firm	-0.573** (0.234)	-0.385 (0.304)
More_employee	-0.194 (0.253)	-0.033 (0.327)
Female_respondent	-0.124 (0.388)	0.012 (0.475)
Accountant	-0.003 (0.216)	-0.050 (0.285)
Higher_educ	0.396* (0.234)	0.184 (0.380)
Age_younger	0.137 (0.232)	-0.275 (0.341)
Prob > chi2	0.4103	0.6781
Pseudo R2	0.0600	0.0687
Number of Observations	177	99

Note. The dependent variable is binary variables, which equals to 1 if respondents gave “ref/no answer”; results are from probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 9. Regression Analysis on CIT evasion (c1b: what proportion of firms like yours (similar size and sector) would you declare less than they should to the tax office of CIT tax?)

Variable	Whole Sample	LTU
Medium	-0.196 (0.302)	--
Female_owner	-0.620** (0.309)	-0.405 (0.452)
Prishtina	0.030 (0.270)	-0.319 (0.423)
Service	0.079 (0.270)	0.487 (0.443)
LLC	0.090 (0.318)	0.428 (0.421)
Construction	-0.387 (0.340)	0.004 (0.508)
Importer	0.212 (0.284)	-0.819 (0.570)
Exporter	0.101 (0.292)	1.020** (0.485)
Newer_firm	0.049 (0.310)	-0.064 (0.499)
More_employee	-0.181 (0.309)	-1.604*** (0.617)
Female_respondent	0.292 (0.509)	1.130 (0.711)
Accountant	-0.226 (0.280)	0.466 (0.406)
Higher_educ	0.027 (0.301)	-0.281 (0.512)
Age_younger	0.335 (0.265)	0.148 (0.426)
Prob > chi2	0.7572	0.1458
Pseudo R2	0.0630	0.2277
Number of Observations	125	69

Note. The dependent variable is a binary variable, which equals to 1 if respondents gave an estimate fall into “1-100%”; results are from a probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 10. Regression Analysis on CIT evasion refusal (c1b: what proportion of firms like yours (similar size and sector) would you declare less than they should to the tax office of CIT tax?)

Variable	Whole sample	LTU
Medium	0.037 (0.290)	--
Female_owner	-0.627** (0.306)	-1.194*** (0.433)
Prishtina	-0.401* (0.241)	-0.778** (0.331)
Service	0.025 (0.227)	0.519 (0.334)
LLC	-0.057 (0.255)	-0.122 (0.327)
Construction	-0.250 (0.294)	-0.524 (0.430)
Importer	-0.113 (0.246)	0.143 (0.389)
Exporter	0.047 (0.235)	0.202 (0.326)
Newer_firm	-0.487** (0.241)	-0.330 (0.340)
More_employee	-0.141 (0.288)	-0.255 (0.362)
Female_respondent	0.469 (0.406)	0.269 (0.531)
Accountant	0.219 (0.229)	0.110 (0.310)
Higher_educ	0.269 (0.269)	0.346 (0.413)
Age_younger	-0.472* (0.244)	-0.681* (0.367)
Prob > chi2	0.211	0.0623
Pseudo R2	0.081	0.1557
Number of Observations	177	99

Note. The dependent variable is binary variables, which equals to 1 if respondents gave “ref/no answer”; results are from probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 11. Regression Analysis on CIT evasion (c2b: for firms like yours, what percentage of the legal value was undeclared to the tax office last year for CIT tax?)

Variable	Whole Sample	LTU
Medium	-0.041 (0.353)	--
Female_owner	-0.338 (0.388)	-0.838 (0.667)
Prishtina	-0.295 (0.321)	-0.767 (0.480)
Service	0.253 (0.317)	0.580 (0.463)
LLC	0.091 (0.386)	0.147 (0.448)
Construction	0.288 (0.424)	-0.078 (0.541)
Importer	-0.031 (0.321)	-0.711 (0.578)
Exporter	-0.013 (0.368)	-0.010 (0.464)
Newer_firm	-0.052 (0.385)	-0.274 (0.588)
More_employee	0.334 (0.347)	-0.296 (0.569)
Female_respondent	-0.733 (0.505)	-0.647 (0.641)
Accountant	0.142 (0.344)	0.947** (0.461)
Higher_educ	0.011 (0.349)	0.243 (0.700)
Age_younger	0.100 (0.327)	-0.143 (0.507)
Prob > chi2	0.9696	0.5875
Pseudo R2	0.0511	0.1513
Number of Observations	88	47

Note. The dependent variable is a binary variable, which equals to 1 if respondents gave an estimate fall into “1-100%”; results are from a probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 12. Regression Analysis on CIT evasion refusal (c2b: for firms like yours, what percentage of the legal value was undeclared to the tax office last year for CIT tax?)

Variable	Whole sample	LTU
Medium	-0.137 (0.271)	--
Female_owner	-0.040 (0.268)	-0.042 (0.375)
Prishtina	-0.177 (0.230)	-0.270 (0.302)
Service	0.002 (0.220)	0.370 (0.298)
LLC	-0.435* (0.247)	-0.431 (0.284)
Construction	0.033 (0.275)	-0.140 (0.366)
Importer	0.314 (0.228)	0.439 (0.350)
Exporter	0.022 (0.226)	0.040 (0.298)
Newer_firm	-0.520** (0.233)	-0.337 (0.304)
More_employee	-0.088 (0.254)	0.053 (0.327)
Female_respondent	-0.128 (0.387)	-0.010 (0.479)
Accountant	-0.030 (0.217)	-0.026 (0.282)
Higher_educ	0.332 (0.234)	0.318 (0.381)
Age_younger	0.186 (0.232)	-0.215 (0.340)
Prob > chi2	0.4022	0.7036
Pseudo R2	0.0614	0.0700
Number of Observations	177	99

Note. The dependent variable is binary variables, which equals to 1 if respondents gave “ref/no answer”; results are from probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 13. Regression analysis on PIT evasion (c3:for firms like yours, what percentage of total employee is unreported to the tax office)

Variable	Whole Sample	LTU
Medium	0.161 (0.283)	--
Female_owner	-0.412 (0.279)	-0.135 (0.381)
Prishtina	0.151 (0.240)	0.044 (0.307)
Service	-0.231 (0.247)	0.101 (0.372)
LLC	0.002 (0.272)	0.025 (0.329)
Construction	-0.081 (0.295)	0.436 (0.439)
Importer	0.046 (0.244)	0.091 (0.363)
Exporter	-0.235 (0.250)	-0.099 (0.348)
Newer_firm	0.374 (0.262)	0.190 (0.356)
More_employee	0.150 (0.266)	-0.806** (0.393)
Female_respondent	0.449 (0.421)	0.567 (0.518)
Accountant	-0.258 (0.232)	-0.081 (0.301)
Higher_educ	0.037 (0.243)	0.701* (0.402)
Age_younger	-0.173 (0.239)	-0.161 (0.336)
Prob > chi2	0.7453	0.5483
Pseudo R2	0.0517	0.1014
Number of Observations	154	85

Note. The dependent variable is a binary variable, which equals to 1 if respondents gave an estimate fall into "1-100%"; results are form a probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 14. Regression analysis on PIT evasion refusal (c3:for firms like yours, what percentage of total employee is unreported to the tax office)

Variable	Whole Sample	LTU
Medium	-0.035 (0.373)	--
Female_owner	-0.273 (0.368)	-0.788 (0.516)
Prishtina	-0.823*** (0.315)	-1.067*** (0.404)
Service	0.240 (0.295)	0.735* (0.430)
LLC	0.494 (0.310)	0.359 (0.387)
Construction	-0.042 (0.373)	0.198 (0.578)
Importer	-0.342 (0.319)	-0.837* (0.474)
Exporter	0.368 (0.295)	0.841** (0.421)
Newer_firm	-0.660** (0.318)	-0.509 (0.420)
More_employee	-0.367 (0.386)	-0.457 (0.479)
Female_respondent	0.654 (0.473)	0.565 (0.541)
Accountant	-0.022 (0.268)	0.002 (0.334)
Higher_educ	0.353 (0.334)	0.742 (0.487)
Age_younger	-0.799** (0.318)	-0.631 (0.407)
Prob > chi2	0.0416	0.0280
Pseudo R2	0.1720	0.2380
Number of Observations	177	99

Note. The dependent variable is binary variables, which equals to 1 if respondents gave “ref/no answer”; results are from probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 15. Regression analysis on PIT evasion (c4:for firms like yours, what percentage of employees earns more than is reported to the tax office)

Variable	Whole Sample	LTU
Medium	0.159 (0.287)	--
Female_owner	-0.366 (0.284)	-0.539 (0.395)
Prishtina	0.124 (0.244)	0.056 (0.317)
Service	-0.491* (0.263)	-0.069 (0.381)
LLC	0.387 (0.287)	0.325 (0.344)
Construction	0.095 (0.298)	0.510 (0.477)
Importer	-0.189 (0.259)	-0.196 (0.398)
Exporter	-0.290 (0.262)	-0.261 (0.359)
Newer_firm	0.074 (0.266)	-0.336 (0.382)
More_employee	0.152 (0.278)	-0.550 (0.412)
Female_respondent	0.351 (0.435)	0.177 (0.546)
Accountant	-0.129 (0.245)	-0.227 (0.328)
Higher_educ	0.205 (0.250)	1.400*** (0.443)
Age_younger	-0.074 (0.247)	0.307 (0.353)
Prob > chi2	0.6195	0.1045
Pseudo R2	0.0663	0.1777
Number of Observations	148	82

Note. The dependent variable is a binary variable, which equals to 1 if respondents gave an estimate fall into “1-100%”; results are from a probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 16. Regression analysis on PIT evasion refusal (c4:for firms like yours, what percentage of employees earns more than is reported to the tax office)

Variable	Whole Sample	LTU
Medium	-0.067 (0.345)	--
Female_owner	-0.129 (0.315)	-0.607 (0.418)
Prishtina	-0.784*** (0.295)	-0.947*** (0.364)
Service	-0.076 (0.260)	0.667* (0.374)
LLC	0.444 (0.280)	0.490 (0.364)
Construction	-0.067 (0.363)	0.130 (0.500)
Importer	-0.385 (0.285)	-0.789* (0.441)
Exporter	0.022 (0.287)	0.723* (0.378)
Newer_firm	-0.660** (0.296)	-0.470 (0.368)
More_employee	-0.434 (0.370)	-0.578 (0.439)
Female_respondent	0.107 (0.511)	-0.047 (0.570)
Accountant	0.192 (0.253)	0.190 (0.325)
Higher_educ	0.783** (0.339)	0.929* (0.477)
Age_younger	-0.341 (0.299)	-0.143 (0.391)
Prob > chi2	0.126	0.067
Pseudo R2	0.157	0.188
Number of Observations	177	99

Note. The dependent variable is binary variables, which equals to 1 if respondents gave “ref/no answer”; results are from probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 17. Regression analysis on F1 and F2

Variable	Bid for a contract	Won a contract
Medium	-0.338 (0.294)	2.085*** (0.736)
Female_owner	0.871*** (0.286)	-0.989** (0.476)
Prishtina	0.274 (0.245)	-0.045 (0.525)
Service	0.408* (0.242)	0.958 (0.611)
LLC	-0.028 (0.254)	0.010 (0.463)
Construction	0.882*** (0.292)	0.165 (0.527)
Importer	0.203 (0.258)	0.430 (0.467)
Exporter	-0.222 (0.247)	1.704** (0.683)
Newer_firm	-0.120 (0.260)	-1.391** (0.662)
More_employee	0.218 (0.284)	1.061 (0.653)
Female_respondent	-0.581 (0.404)	0.926 (1.034)
Accountant	-0.003 (0.236)	0.045 (0.402)
Higher_educ	0.291 (0.264)	0.768 (0.559)
Age_younger	-0.004 (0.243)	-0.629 (0.583)
Prob > chi2	0.0029	0.3859
Pseudo R2	0.1539	0.2484s
Number of Observations	177	52

Note. The dependent variables are all binary variables reported at the top of each regression result column; all the results are results of a series of probit regression analysis; robust standard errors are in parentheses; 4 observations were dropped during analysis due to missing values; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 18. Regression analysis on F3a and F3b

Variable	Illegal practice (bribery)	Non-competitive (influence a friend)
Medium	-1.974** (0.833)	-2.006** (0.839)
Female_owner	-0.178 (0.531)	-0.213 (0.575)
Prishtina	0.427 (0.568)	0.0718 (0.553)
Service	-0.624 (0.590)	-0.961 (0.674)
LLC	0.431 (0.507)	0.685 (0.546)
Construction	0.0168 (0.564)	0.198 (0.543)
Importer	-0.278 (0.633)	0.0154 (0.585)
Exporter	-1.368** (0.549)	-1.296** (0.506)
Newer_firm	0.400 (0.574)	0.827 (0.601)
More_employee	-1.987*** (0.702)	-2.089*** (0.719)
Female_respondent	-1.267 (0.949)	-1.204 (0.824)
Accountant	0.936** (0.471)	0.835* (0.474)
Higher_educ	-1.838** (0.749)	-1.612** (0.774)
Age_younger	1.455* (0.769)	1.499** (0.694)
Won a contract	1.660*** (0.611)	1.420** (0.588)
Prob > chi2	0.0961	0.0458
Pseudo R2	0.3253	0.3412
Number of Observations	50	50

Note. The dependent variables are all binary variables reported at the top of each regression result column; all the results are results of a series of probit regression analysis; robust standard errors are in parentheses; 4 observations were dropped during analysis due to missing values; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 19. Regression analysis F4a & F4b

Variable	Low-level public officials	High-ranking politicians
Medium	0.652* (0.352)	0.392 (0.316)
Female_owner	0.109 (0.343)	0.135 (0.329)
Prishtina	-0.212 (0.269)	-0.347 (0.273)
Service	-0.107 (0.267)	0.209 (0.266)
LLC	-0.421 (0.296)	-0.367 (0.300)
Construction	-0.293 (0.341)	-0.176 (0.326)
Importer	-0.120 (0.267)	-0.181 (0.271)
Exporter	0.178 (0.271)	-0.051 (0.267)
Newer_firm	0.171 (0.292)	-0.036 (0.278)
More_employee	0.445 (0.332)	0.336 (0.310)
Female_respondent	--	--
Accountant	-0.046 (0.268)	-0.053 (0.267)
Higher_educ	0.011 (0.289)	0.098 (0.289)
Age_younger	-0.195 (0.265)	0.027 (0.264)
Bid for a contract	0.253 (0.278)	-0.183 (0.271)
Prob > chi2	0.6230	0.6230
Pseudo R2	0.0681	0.0681
Number of Observations	122	126

Note. The dependent variables are all binary variables reported at the top of each regression result column; all the results are results of a series of probit regression analysis; robust standard errors are in parentheses; 4 observations were dropped during analysis due to missing values; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$. “Female_respondent” is excluded from regression analysis because of perfect collinearity problem.

Table 20. Regression analysis on refusal F4a&F4b

Variable	Low-level public officials	High-ranking politicians
Medium	0.488* (0.290)	0.436* (0.265)
Female_owner	0.281 (0.280)	0.0367 (0.287)
Prishtina	0.341 (0.231)	0.256 (0.227)
Service	-0.0548 (0.236)	-0.280 (0.237)
LLC	-0.000 (0.255)	0.066 (0.261)
Construction	-0.280 (0.315)	-0.201 (0.296)
Importer	0.125 (0.236)	-0.034 (0.234)
Exporter	-0.457* (0.244)	-0.503** (0.248)
Newer_firm	-0.499** (0.242)	-0.144 (0.249)
More_employee	-0.024 (0.270)	0.262 (0.272)
Female_respondent	--	--
Accountant	-0.050 (0.223)	-0.050 (0.228)
Higher_educ	-0.0630 (0.242)	-0.043 (0.253)
Age_younger	0.190 (0.221)	0.280 (0.221)
Bid for a contract	-0.140 (0.254)	-0.161 (0.253)
Prob > chi2	0.1050	0.4737
Pseudo R2	0.0880	0.0672
Number of Observations	177	177

Note. The dependent variable is binary variables, which equals to 1 if respondents gave “ref/no answer”; results are from probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 21. Regression analysis F4c & F4d

Variable	Exchanging favors	Use of personal contacts
Medium	0.336 (0.302)	0.129 (0.323)
Female_owner	-0.036 (0.340)	-0.122 (0.326)
Prishtina	-0.431 (0.266)	-0.252 (0.267)
Service	0.095 (0.257)	-0.012 (0.259)
LLC	-0.020 (0.288)	-0.338 (0.288)
Construction	-0.139 (0.310)	-0.258 (0.340)
Importer	-0.297 (0.267)	-0.215 (0.269)
Exporter	-0.289 (0.261)	-0.163 (0.266)
Newer_firm	0.060 (0.274)	-0.129 (0.275)
More_employee	-0.083 (0.294)	0.012 (0.307)
Female_respondent	--	--
Accountant	0.142 (0.262)	-0.010 (0.261)
Higher_educ	0.162 (0.270)	0.333 (0.280)
Age_younger	0.056 (0.255)	-0.089 (0.262)
Bid for a contract	0.162 (0.266)	-0.021 (0.276)
Prob > chi2	0.6485	0.9248
Pseudo R2	0.0673	0.0446
Number of Observations	130	125

Note. The dependent variables are all binary variables reported at the top of each regression result column; all the results are results of a series of probit regression analysis; robust standard errors are in parentheses; 4 observations were dropped during analysis due to missing values; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$. “Female_respondent” is excluded from regression analysis because of perfect collinearity problem.

Table 22. Regression analysis on refusals F4c&F4b

Variable	Exchanging favors	Use of personal contacts
Medium	0.325 (0.267)	0.374 (0.273)
Female_owner	0.213 (0.274)	-0.108 (0.280)
Prishtina	0.257 (0.231)	0.253 (0.224)
Service	-0.212 (0.231)	-0.135 (0.232)
LLC	-0.177 (0.260)	0.058 (0.251)
Construction	-0.389 (0.299)	-0.310 (0.303)
Importer	0.0363 (0.240)	0.020 (0.231)
Exporter	-0.120 (0.246)	-0.292 (0.246)
Newer_firm	0.044 (0.247)	-0.052 (0.247)
More_employee	0.433 (0.275)	0.254 (0.269)
Female_respondent	--	--
Accountant	-0.320 (0.229)	-0.043 (0.220)
Higher_educ	-0.071 (0.251)	-0.165 (0.246)
Age_younger	0.149 (0.224)	0.071 (0.215)
Bid for a contract	-0.034 (0.253)	-0.073 (0.248)
Prob > chi2	0.7591	0.8859
Pseudo R2	0.0491	0.0376
Number of Observations	177	177

Note. The dependent variable is binary variables, which equals to 1 if respondents gave “ref/no answer”; results are from probit regression analysis; robust standard errors are in parentheses; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 23. Regression Analysis on D4

Variable	Cabinet	TAK	Politician
Medium	0.342 (0.299)	-0.436 (0.292)	0.442 (0.282)
Female_owner	0.048 (0.272)	0.0162 (0.287)	-0.603* (0.326)
Prishtina	0.054 (0.239)	0.721*** (0.238)	-0.389 (0.245)
Service	0.178 (0.247)	-0.128 (0.234)	-0.421* (0.234)
LLC	0.225 (0.253)	-0.246 (0.276)	0.063 (0.247)
Construction	-0.196 (0.312)	0.620** (0.283)	-0.159 (0.301)
Importer	0.249 (0.260)	-0.123 (0.245)	-0.332 (0.240)
Exporter	-0.364 (0.249)	0.383 (0.243)	0.116 (0.245)
Newer_firm	0.161 (0.268)	-0.102 (0.245)	0.203 (0.249)
More_employee	0.575* (0.314)	-0.601** (0.279)	-0.078 (0.275)
Female_respondent	-0.147 (0.418)	0.346 (0.415)	0.000 (0.419)
Accountant	-0.212 (0.225)	-0.197 (0.243)	0.378* (0.227)
Higher_educ	0.120 (0.244)	0.0784 (0.244)	-0.238 (0.247)
Age_younger	-0.302 (0.252)	0.262 (0.233)	-0.029 (0.247)
Prob > chi2	0.618	0.024	0.048
Pseudo R2	0.066	0.130	0.110
Number of Observations	177	177	177

Note. The dependent variables are all binary variables reported at the top of each regression result column; all the results are results of a series of probit regression analysis; robust standard errors are in parentheses; 4 observations were dropped during analysis due to missing values; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

Table 24. Regression analysis on D4

Variable	Most successful way
Medium	-0.407 (0.289)
Female_owner	0.516* (0.300)
Prishtina	-0.600** (0.266)
Service	0.480* (0.256)
LLC	0.003 (0.280)
Construction	-0.366 (0.340)
Importer	0.461 (0.286)
Exporter	-0.271 (0.269)
Newer_firm	-0.232 (0.247)
More_employee	0.182 (0.258)
Female_respondent	-0.111 (0.499)
Accountant	-0.029 (0.243)
Higher_educ	0.097 (0.275)
Age_younger	0.071 (0.266)
Prob > chi2	0.1239
Pseudo R2	0.1475
Number of Observations	177

Note. The dependent variables are all binary variables reported at the top of each regression result column; all the results are results of a series of probit regression analysis; robust standard errors are in parentheses; 4 observations were dropped during analysis due to missing values; * $p < 0.1$. ** $p < 0.05$. *** $p < 0.01$.

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