Chapter 10.

Tax policy in South East Europe

Effective tax policy aims to strike a balance between the tax burden on enterprises and individuals, while still allowing the government to raise the revenue required to deliver public services and finance public policy objectives. Three sub-dimensions make up the overall Tax Policy Dimension. The Corporate Tax Policy Sub-Dimension analyses to what extent tax legislation fosters an environment conducive to business and effective tax revenue collection, in the form of tax incentives, transfer pricing rules, tax treaties and regional co-operation. The Tax Administration Sub-Dimension investigates the functions of tax administrators and their ability to ensure tax compliance. The Tax Analysis Sub-Dimension evaluates the ability of tax authorities to collect tax statistics and analyse tax policy effectiveness and their impact on government budgets.

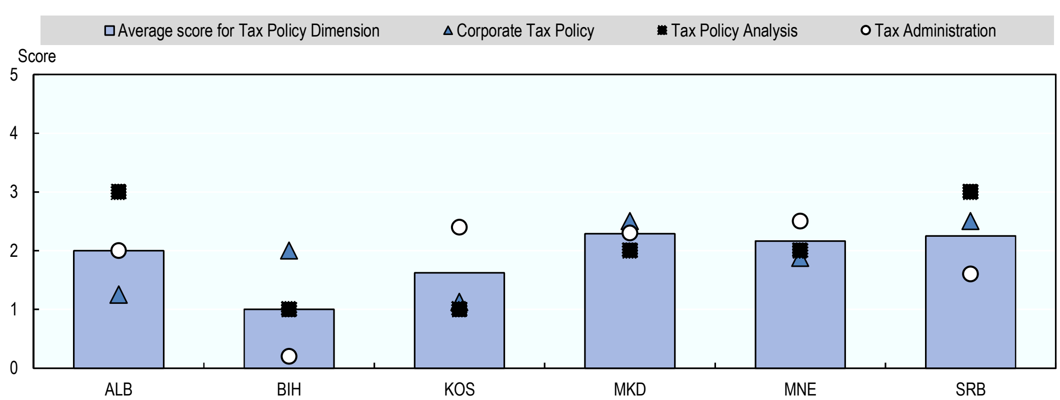
Main findings

Well-functioning tax systems are an essential component of a competitive fiscal environment that fosters investment, risk taking and entrepreneurship. Effective tax policy also helps strike a balance between the tax burden on enterprises and individuals while raising the revenue required to deliver public services and finance public policy objectives.

Over the years, tax revenues have steadily risen throughout South East Europe (SEE), with only a small portion of the increase attributable to improved labour participation, since employment levels have generally stagnated in the region. Payment procedures and the filing of tax returns have grown steadily less complex and costly, thus improving compliance among the general public and business throughout the region. The SEE economies have also begun to build the institutional capacities and policies that support a competitive, vibrant private sector, while ensuring the collection of taxes to fund government operations. However, a number of challenges remain, such as the need for continued modernisation of tax systems and better defined tax incentives.

The degree of development of tax systems varies from one SEE economy to another. Most, however, have legislative and institutional frameworks in place and are implementing them – again to varying degrees.

Figure 10.1. **Tax Policy: Dimension and Sub-Dimension average scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Different factors shape tax policy performance in South East Europe. For example, Bosnia and Herzegovina's low average performance is due, in part, to the fact that each entity – rather than the state – administers its own tax policy. Both Serbia and Albania can, to a certain extent, attribute their higher-than-average performances to their relatively more developed tax policy analysis practices, which include the collection of tax statistics and efforts to improve their analytical capacities. Most of the SEE economies have performed well in corporate tax policy because they have signed a number of tax agreements to avert double taxation between firms and have drawn up clearer transfer pricing rules.

Achievements

The SEE economies have seen improvements in the foundations of their tax policy.

SEE economies have signed and ratified tax treaties with each other and with EU countries to help eliminate issues of double taxation.

SEE economies are streamlining and modernising filing and payment procedures. Most economies have introduced electronic procedures for certain types of taxes, which has reduced the time associated with filing tax returns and payments.

SEE economies have introduced transfer pricing rules in order to ensure that the price and other conditions of transactions between associated enterprises are consistent with those that would occur between unrelated enterprises.

SEE economies have initiated efforts to build tax analysis capacities. They include the development of legislation and institutional capacities required for the regular collection of tax statistics and data in most SEE economies.

Challenges

Despite progress, SEE economies have room to improve their tax policy development and implementation.

Tax incentives are not fully aligned with EU acquis as defined by the EU Code of Conduct for Business Taxation. Moreover, clear sunset clauses are still to be introduced as a signal to firms that tax incentives are temporary and are designed to facilitate monitoring and evaluation and to curb abuse.

Taxpayer services are not fully developed. Tax authorities in the region are not always staffed by personnel with the necessary skills and knowledge to effectively answer taxpayers' enquiries. Modern tax administration organisational systems and tools (e.g. web-based information and auditing systems) would allow staff to carry out their tasks more effectively.

Tax policy analysis is at an early stage of development. Although the collection and communication of tax statistics have improved, modelling and forecasting methods are required for meaningful tax policy analysis. Tax expenditure reporting is also limited in most SEE economies

Modern tax return filing and payment procedures are not uniformly implemented. Progress in developing electronic systems for tax collection is uneven between the economies and their coverage could be widened.

Tax authorities often have limited autonomy over their operations. Limited measures are being taken to give tax authorities the power to manage their own budget, determine their own organisational structure and manage their human resources (recruitment, dismissal, wages). Further efforts are also required to change the professional environment and culture of tax officials and to strengthen tax administration.

Recommendations

Steps to address identified challenges can strengthen tax policy in the region to help reach government objectives and create a stable investment environment.

Review tax incentives to ensure compliance with the EU acquis. Relatively straightforward measures could be taken to ensure that all tax incentives and corporate tax exemptions are in line with the EU Code of Conduct for Business Taxation.

Further develop taxpayer services throughout the region. SEE economies could ensure that information on how to file and pay taxes is made available online or through telephone and in-person enquires. Further efforts to modernise tax filing systems could focus on electronic filing and payment procedures for most types of taxes in order to support increasing levels of taxpayer self-service. In this regard, it is essential to ensure that systems and procedures are well designed and compliance issues addressed from the outset. The SEE economies could also consider intensifying their efforts to respond to appeals and requests for information in a timely and efficient manner.

Increase staff capability. It is important that the SEE tax authorities possess the necessary knowledge and skills to effectively perform their duties. Staff competence, integrity and performance are of critical importance. Staff are the single largest component of tax administration costs and are widely seen as the single most important asset in good tax administration. However, as tax authorities move towards modernisation of services, fewer staff will be needed.

Increase the capacity of SEE tax authorities to analyse tax policy analysis more effectively and explore ways in which the tax authorities can better allocate resources to train and hire staff. The result would be the capacity to undertake more robust tax policy analysis – namely modelling and forecasting tax revenues – and tax expenditure reporting.

Improve tax filing and payment procedures. Work done in the last few years has helped ease the burden of filing tax returns and paying taxes. Filing tax returns should be kept simple and e-filing used for as many taxes as possible.

Consider increasing the autonomy of tax authorities. Autonomy will allow tax administrators to perform in an efficient and effective manner. A suitable level of autonomy would be the power to design and implement their operational policy, independently manage their budget, recruit and develop staff (which would include setting pay levels), interpret tax laws and exercise enforcement.

Improve the implementation of the transfer pricing regime by stating the acceptable transfer pricing methods and documentation obligations in the transfer pricing guidelines. In order to eliminate double taxation and to prevent base erosion and profit shifting by multinational enterprises through transfer pricing, the SEE economies could consider aligning their transfer pricing rules with the OECD Transfer Pricing Guidelines (OECD, 2010a).

Overview

To ensure that the state functions effectively, governments need to mobilise domestic resources. Sound tax systems and policies are central to achieving public policy objectives and a favourable investment environment (OECD, 2015). They enable governments to deliver public services, meet social needs, like education, health and social security, and build and maintain infrastructure. The underlying design of a tax system influences economic decisions concerning domestic and international investment, output, labour supply and demand, and savings rates. Moreover, the level of taxation and the design and administration of tax policy directly affect business costs and returns on investment. Tax reform thus plays an important role in building competitive fiscal environments that promote investment, risk taking and entrepreneurship and optimise tax revenue by encouraging compliance and collection and deterring evasion (OECD, 2015).

An essential component of a competitive fiscal environment is efficient tax administration. It facilitates compliance by making tax procedures as easy and seamless as possible and minimises government costs. Tax administration reform generally aims to modernise management and operational structures, and expand and enhance taxpayer services.

The Tax Policy Dimension is linked to other policy areas examined in this report, in particular:

- **Chapter 1. Investment policy and promotion** and foreign direct investment are facilitated by a sound tax environment including tax systems with the right institutional and legislative frameworks to avert double taxation. SEE economies could co-operate on harmonising tax policies to prevent a taxation-related "race to the bottom", which would be detrimental to national tax bases and the ability to fund long-term investment.
- **Chapter 11. Competition policy** is strengthened by transparent tax policies that help prevent the tax evasion and avoidance that harms market competition and the efficient allocation of resources in the economy. Large companies operating across borders are better positioned to engage in aggressive tax practices and ultimately gain an unfair competitive advantage over domestic competitors. Hence the need for strong regional and international co-operation in curbing such harmful practices (OECD, 2014a)
- **Chapter 8. Environmental policy** can be supported by tax-related incentives to help reduce environmental footprints. Environmental tax policy and carbon taxation in particular are becoming important aspects of policy design in a number of countries.
- **Chapter 4. Research, development and innovation** are facilitated by predictable tax rates and credible policy commitments as they create environments conducive to innovation. Moreover, tax incentives for R&D activities on the cost or income side show that economies wish to encourage R&D. Environmental taxes (such as levies on emissions) may also steer firms towards innovation in order to reduce both pollution and the tax burden.

Box 10.1. **Tax Policy Dimension in the SEE 2020 Strategy**

Elements of tax policy are found in the Sustainable Growth Pillar of the South East Europe 2020 Strategy (SEE 2020). The central objective of the Sustainable Growth Pillar is to boost growth and jobs by supporting a strong, diversified and competitive economic base, while becoming better connected, more sustainable and more resource-efficient. The Competitiveness Dimension in the Sustainable Growth Pillar outlines how SME development can be supported through greater access to finance, peer reviews of SME development policy and an improved general business environment. It specifically addresses the need for closer co-operation between economies to harmonise tax policy and eliminate double taxation.

The official SEE 2020 Strategy Co-ordinator for the Tax Policy Dimension is the Regional Cooperation Council (RCC). The RCC seeks to promote and enhance regional co-operation in South East Europe and is the overall co-ordinator of the SEE 2020 Strategy.

Source: RCC (2013), *South East Europe 2020: Jobs and prosperity in a European perspective*, www.rcc.int/files/user/docs/reports/SEE2020-Strategy.pdf.

Tax Policy Dimension assessment framework

This chapter assesses the Tax Policy Dimension of the SEE 2020 Strategy's Sustainable Growth Pillar. It gauges the SEE economies' efforts to develop tax policies that foster investment and competitiveness and build the institutional capacity for effective tax administration.

The chapter is selective in scope. It does not attempt a comprehensive evaluation of tax systems or rates. It confines itself to three aspects – or sub-dimensions – of tax policy and uses qualitative and quantitative indicators to assess the SEE economies' performance. The three sub-dimensions are:

- Corporate Tax Policy

  Does tax legislation in the SEE economies foster an environment conducive to business and effective tax revenue collection? How does it affect investment and competitiveness levels?

- Tax Administration

  What are the functions of tax administrators? How effectively are they able to ensure tax compliance?

- Tax Policy Analysis

  Do the tax authorities have the capacity to collect tax statistics and analyse such facets of tax policy as changes in rates and the effect on budgets?

Figure 10.2 shows how the sub-dimensions and their constituent indicators make up the Tax Policy Dimension assessment framework.

Figure 10.2. **Tax Policy Dimension assessment framework**

<table>
<tr><th colspan="3">Tax Policy Dimension</th></tr>
<tr><td colspan="3">SEE 2020 headline target
• Increase overall employment rate
Outcome indicators
• Share of firms identifying tax as a constraint
• Number of annual tax payments by firms
• Time to comply with tax laws
• Total tax revenue</td></tr>
<tr><td>Sub-Dimension 1
Corporate Tax Policy</td><td>Sub-Dimension 2
Tax Administration</td><td>Sub-Dimension 3
Tax Policy Analysis</td></tr>
<tr><td>Qualitative indicators
1. Tax incentives
2. Transfer pricing rules
3. Tax treaties
4. Regional co-operation</td><td>Qualitative indicators
5. Functions and organisation
6. Compliance assessment and risk management
7. Independence and transparency
8. Tax filing and payment procedures
9. Taxpayer services</td><td>Qualitative indicators
10. Tax statistics
11. Modelling and forecasting
12. Tax expenditure reporting</td></tr>
<tr><td>Quantitative indicators</td><td>Quantitative indicators
1. Per capita annual expenditure on tax administration
2. Number of staff employed in tax administration</td><td>Quantitative indicators</td></tr>
</table>

Each sub-dimension is assessed through quantitative data and qualitative information, which the Regional Cooperation Council (RCC) collected with the support of the OECD.

Quantitative indicators are drawn from national or international statistics, while qualitative indicators are scored in ascending order on a scale of 0 to 5.[1]

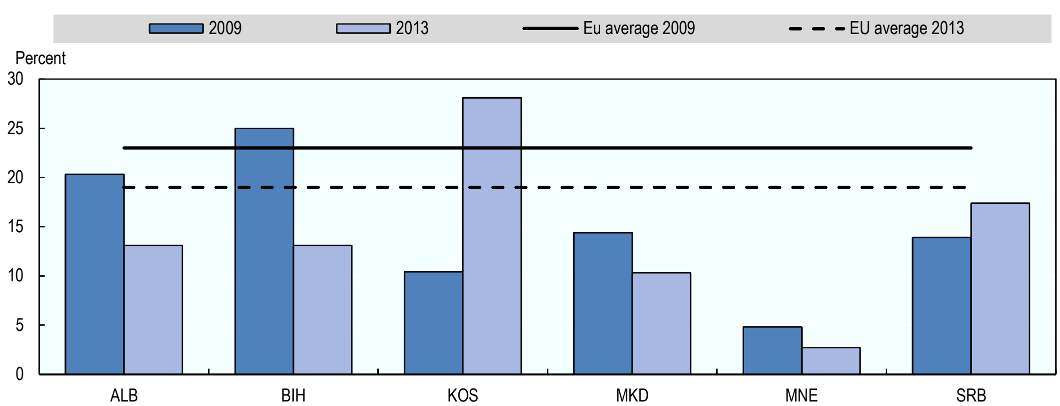
Tax policy performance in SEE economies

The administration of tax laws should encourage and facilitate enterprise growth potential and investment levels. According to the 2013 World Bank Enterprise Survey, most South East European entrepreneurs have seen improvements in tax administration. The filing of tax returns and payment procedures have been modernised and simplified and will ultimately ease constraints on enterprise growth.

Two notable exceptions are Kosovo and Serbia, where businesses continue to report difficulties in dealing with the tax authorities due, in part, to low or no progress in reducing the number of tax payments and the length of time it takes to pay them (Figures 10.4 and 10.5). By contrast, thanks to significant efforts to reduce the tax administration burden, firms in Montenegro and the Former Yugoslav Republic do not claim that it is a constraint on business. As for Bosnia and Herzegovina, persistent difficulties there are attributable to the fact that tax collection is performed at the entity level, which negatively affects enterprises operating across the entities and filing multiple returns.

Figure 10.3. **Firms identifying tax administration as a major constraint, 2009 and 2013**

Percent



Note: Data of Albania for the year 2009 as of 2007.

Source: World Bank (2015a), *Enterprise Surveys* (database), www.enterprisesurveys.org/data.

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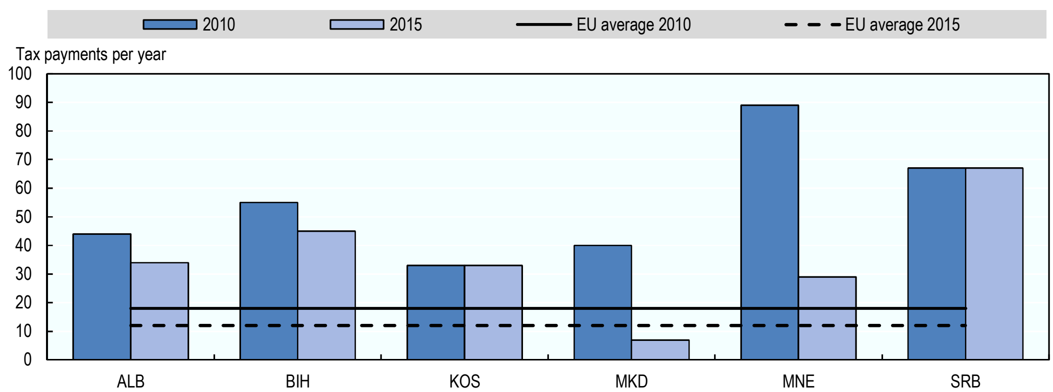
Nevertheless, there are clear indications throughout the region that the tax procedure burden on firms has eased. For instance, the World Bank's *Doing Business Report 2016* shows the number of taxes that companies pay has fallen in most of the region's economies (Figure 10.4), except in Kosovo and Serbia, where there has been no change. The Former Yugoslav Republic of Macedonia and Montenegro, in particular, have seen substantial drops over the last five years. Overall, however, the number of taxes that businesses have to pay is well above the EU average, save in the Former Yugoslav Republic of Macedonia.

Another trend is the decline in the number of hours that firms are required to spend complying with tax laws (Figure 10.5), although the drop is not as pronounced as in the EU (Bank, 2014). And, apart from Kosovo and the Former Yugoslav Republic of Macedonia, the SEE economies still take considerably more time to comply than in the European Union. In Bosnia and Herzegovina, Albania, and Montenegro, they take nearly twice as long.

Figure 10.4. **Number of tax payments firms have to make, 2010 and 2015**

Tax payments per year



Source: World Bank (2015b), *Doing Business* (database), www.doingbusiness.org/data.

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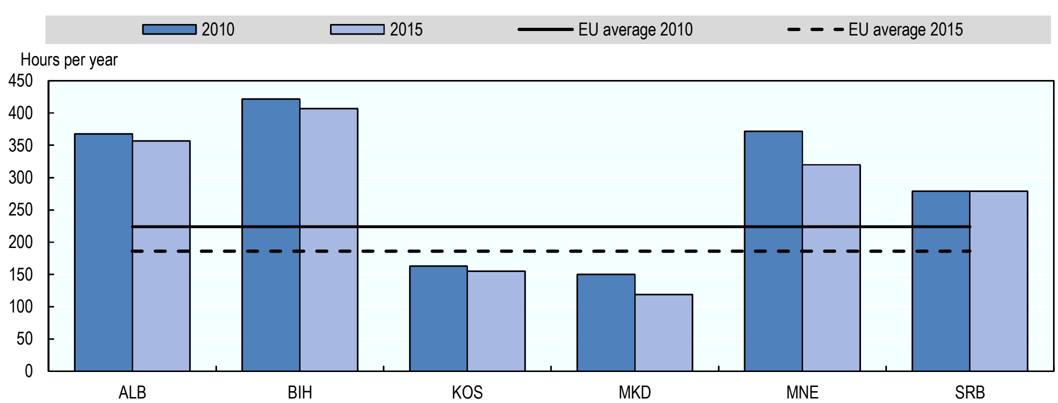
Figure 10.5. **Time to comply with tax laws, 2010 and 2015**

Hours per year



Source: World Bank (2015b), *Doing Business* (database), www.doingbusiness.org/data.

StatLink http://dx.doi.org/10.1787/888933322260

Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro saw an average 21% increase in tax revenue between 2010 and 2014.[2] The rise was, in part, the result of modernised systems for filing tax returns that cut paperwork and the introduction of electronic e-filing and e-payment.

Corporate Tax Policy Sub-Dimension

Taxing corporate profits directly affects companies' after-tax profitability. In addition to high tax rates, unclear legislation and rules deter business and investment by raising project costs and uncertainty over net profitability. The overall performances of the SEE economies in the Corporate Tax Policy Sub-Dimension are obtained by assessing how they fare against four qualitative indicators.

- **Tax incentives** are a policy instrument that is widely used to attract larger flows of foreign investment. Incentives should have clear policy goals, revenue targets, transparent eligibility criteria and implementation rules, and they should include "sunset clauses" which state the date after which they expire. The method by which an economy attracts FDI is complex and springs, first and foremost, from the need to foster a competitive investment climate, which includes building a competitive tax environment that is transparent, certain and fair. Tax incentives should be used to attract investment flows from abroad when there is a positive benefit, such as knowledge spillover. EU accession countries, candidate countries and potential candidate countries are expected to follow the EU Code of Conduct for Business Taxation. It defines the tax legislation *acquis* and seeks to eliminate tax incentives which could cause harmful tax competition within the EU.

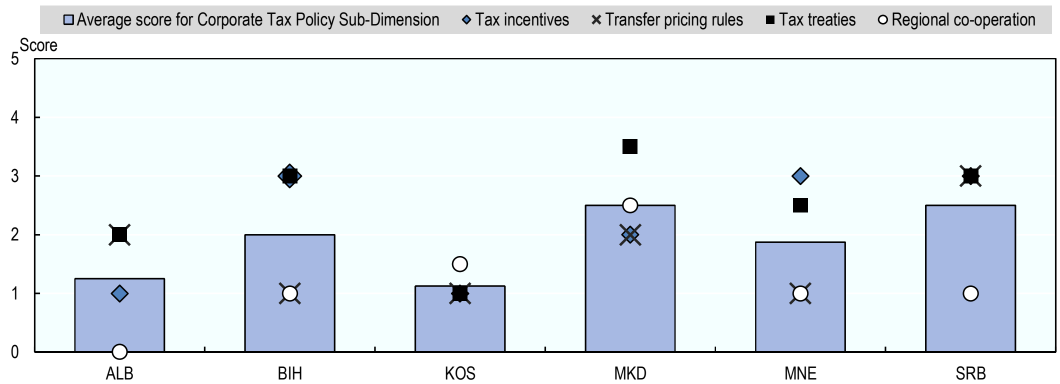
- **Transfer pricing rules** ensure that multinational enterprises do not have opportunities to engage in base erosion and profit shifting. The rules guarantee that transactions between one part of a multinational group and another part of the same group are conducted in accordance with the arm's length principle. The arm's length principle requires that transactions between related enterprises ("transfer pricing") should be priced in the same manner as between unrelated enterprises in the same or similar circumstances.

- **Tax treaties** attract investors because they provide certainty in the taxation of cross-border trade and activities and eliminate double taxation. Policy makers from the region could review the scope and content of tax treaties and endeavour to adopt the tax treaty provisions based on the OECD's income and capital model treaty (OECD, 2012) or the UN's double taxation model agreement (UN, 2011). Such a course of action would address the most common problems in the field of double taxation in accordance with tax treaty policies adopted by other countries.

- **Regional co-operation** on tax policy would help the SEE economies harmonise their current frameworks and practices and maximise tax revenues – without running the risk of a race to the bottom (i.e. lure foreign investors with the lowest tax rates).

SEE economies are at different stages of development in their corporate tax policies (Figure 10.6). The more advanced – the Former Yugoslav Republic of Macedonia and Serbia – have legislative frameworks in place and are starting to execute them. The less developed economies, Albania and Kosovo, are drafting their tax policy frameworks.

Figure 10.6. **Corporate Tax Policy: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Further efforts are required to improve the legal and regulatory frameworks for tax incentives and transfer pricing

The tax incentive frameworks of the SEE economies vary, as Table 10.1 shows. Bosnia and Herzegovina, Montenegro and Serbia have better developed tax incentive policies than their peers in the region, with clear provisions that include eligibility criteria. Within Bosnia and Herzegovina, tax benefits vary from one administrative entity (the Federation of Bosnia and Herzegovina and Republika Srpska) to another. But all have sunset clauses and are harmonised with EU standards in the Code of Conduct and Business Taxation.

Table 10.1. **Corporate Tax Policy Sub-Dimension: Tax incentives indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Tax incentives	1.0	3.0	1.0	2.0	3.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Tax exemptions and incentives in the Former Yugoslav Republic of Macedonia and Montenegro, target economic sectors. In the Former Yugoslav Republic of Macedonia, they are designed for companies that have operated in technological and industrial development zones for 10 years and for trade businesses that meet certain eligibility criteria. Kosovo, by contrast, is still drafting tax incentives and should clearly define guidelines for implementation.

Improve transfer pricing methodologies and transfer pricing documentation obligations

To prevent unfair practices and curb tax avoidance, SEE economies have adopted transfer pricing rules. However, legal provisions often fail to clearly define transfer pricing methods, as in the Former Yugoslav Republic of Macedonia, for example, and Bosnia and Herzegovina, and Montenegro, where the arm's length principle is only partially observed. In Montenegro, the Ministry of Finance is introducing secondary legislation to further develop the regulatory framework for transfer pricing rules. In Kosovo, however, rules are clearly spelled out and in line with OECD guidelines (OECD, 2010a). However, there is no administrative institution that regulates transfer pricing rules and efforts to establish one have made little progress since 2013.

Table 10.2. **Corporate Tax Policy Sub-Dimension: Transfer pricing indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Transfer pricing rules	2.0	1.0	1.0	2.0	1.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Align tax treaties more closely with international guidelines and strengthen regional tax policy co-operation

Regional co-operation is relatively underdeveloped in the region, with very few meetings on harmonising tax policy taking place between economies (Table 10.3). The Former Yugoslav Republic of Macedonia and Serbia have some of the best developed legislative frameworks governing tax treaties.

Table 10.3. **Corporate Tax Policy Sub-Dimension: Cross-border taxation legislation indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Tax treaties	2.0	3.0	1.0	3.5	2.5	3.0
Regional co-operation	0.0	1.0	1.5	2.5	1.0	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323449

Most of the economies are signatories to multiple tax treaties – a Yugoslavian legacy. However, Kosovo (which has a score of 1) is an exception to that rule, as it is party to only 11 double taxation treaties, although it is signing and bringing into force three more. The other economies have all signed and executed over 40 treaties each, with Serbia having as many as 55 to its name. Most tax treaties seek to follow international guidelines, such as the OECD and UN model tax conventions (OECD, 2012; UN, 2011), which include provisions for assistance in tax collection, dispute resolution (the mutual agreement procedure) and the exchange of information between the competent national authorities.

Although there are variations in the SEE economies' performance against the regional co-operation indicator, most score relatively low because they have made only limited efforts that have been limited chiefly ad hoc.

The way forward in corporate tax policy

As there are considerable variations between the SEE economies in tax incentives, they could go about making them more effective in different ways. Albania and Kosovo, for example, could endeavour to develop corporate tax incentives and/or align them with clear policy goals. And they could build their capacity to administer tax incentives and better define implementation instructions. All the economies stand to gain from aligning tax incentives more closely with the EU *acquis*, namely the EU standards on the Code of Conduct for Business Taxation. And they could all also work to set up independent bodies to review the effectiveness of tax incentives and adjust policies according to the bodies' recommendations.

Most SEE economies would, in the future, benefit from further work to improve their respective transfer pricing regulatory frameworks so that they clearly set out the transfer pricing methods that can be used, for example, and the documents that are required. At the same time, they should move to ensure that regulatory frameworks are in line with the OECD transfer pricing guidelines. The SEE economies could also conclude bilateral or multilateral advance pricing agreements with their tax treaty partners in order to provide taxpayers with greater upfront certainty on the prices for their related party transactions.

As they move forward, it is recommended that the SEE economies keep up their efforts to negotiate and sign additional tax treaties, especially with their major trade and investment partners. Agreements should comply with international guidelines, such as the OECD's income and capital model treaty (OECD, 2012) or the UN's double taxation model agreement (UN, 2011). Treaties should contain provisions for assistance in tax collection and dispute resolution (the mutual agreement procedure) as well as provisions for international standards of transparency and exchange of information for tax purposes. The intensification of co-operation efforts will help the SEE economies to reap the full benefits of harmonisation and maximise tax revenue.

Tax Administration Sub-Dimension

Sound tax policies and legislation are not enough to guarantee that tax systems are competitive. Governments must implement tax frameworks consistently and transparently through efficient tax administration that maximises compliance and revenue collection. From a business perspective, efficient tax administration also limits the costs of taxpayer compliance.

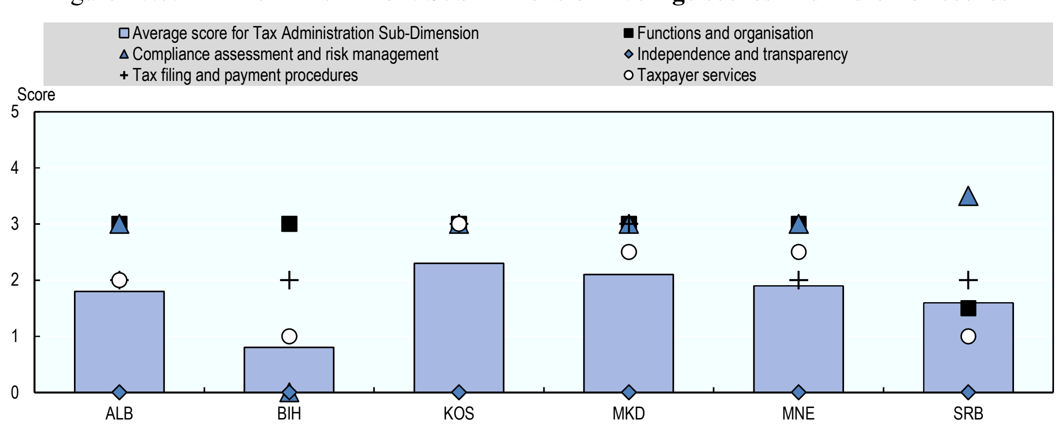
Tax compliance refers to the key obligations of taxpayers under the tax system: registration for tax purposes, filing tax returns, correcting and reporting tax liabilities, and paying taxes on time. Tax administration facilitates compliance by good design, effective procedures and services and monitoring compliance behaviour. Well-developed tax audit capabilities are an important element in helping tax authorities manage risks and collect total tax due. How the SEE economies perform in the Tax Administration Sub-Dimension as a whole is gauged by how they fare against five qualitative indicators.

- A prerequisite for efficient, effective tax administration requires strategic systems design, supported by internal **functions and organisational** capabilities. A key factor in this respect is a single tax authority which covers all taxes and performs all core tax administration functions.
- To effectively monitor **compliance assessment and risk management**, tax administration should incorporate a system for referring the riskiest declarations for audit and assigning them, in order of risk, to the available resources. Audit results should also be regularly reported and assessed to inform and help improve the tax authority's overall risk management model. When it comes to compliance, procedural justice is an important issue, as people's perceptions of fair and unfair taxation shape their willingness to comply with tax rules and regulations.

- Only tax authorities characterised by **independence and transparency** provide the necessary safeguards when collecting tax obligation from taxpayers and will be perceived as legitimate. Corrupt tax collectors deter people from paying their taxes formally, prompting them to opt for bribery or join the informal economy. Similarly, transparency prevents pressure from politicians who renege on established tax laws or use their powers of taxation to discriminate against their rivals. Transparent, independent tax administration enables government to demonstrate to taxpayers its credibility and the integrity of its tax procedures and to reassure the private sector that it will not abuse the power to tax.
- Companies' tax-paying duties are not limited to **tax filing and payment procedures**, but also to register, provide documentation and report – all of which can come at a considerable cost, especially to SMEs. Streamlining compliance procedures helps reduce those costs. The tax filing and payment procedures indicator assesses the smoothness of taxpaying formalities and whether efforts have been made to streamline them through the use of simplified or pre-filled tax returns, clear and user-friendly methods for calculating tax due, and the provision of e-filing and e-payment.
- **Taxpayer services** in the form of tax authorities' support to corporate taxpayers to access the requisite information facilitate the ability of corporate taxpayers to file tax returns correctly. Hence the importance of evaluating the types of taxpayer services offered by the tax authorities. They typically include taxpayer information and assistance, responding to in-person and telephone inquiries, the handling of appeals, and the availability of online filing and payment systems. Good services help maximise voluntary compliance by providing the advice and support that businesses need to meet their tax obligations.

Four SEE economies score a 2 or higher, which denotes a moderately well-developed tax administration environment. Bosnia and Herzegovina stands as a regional outlier (Figure 10.7). It has a less developed tax administrative regime, having no single state-level definitions of tax administrative functions and organisations, tax filing and payment procedures, or risk management techniques. However, it is important to note that those elements do exist at the sub-national entity level in Bosnia and Herzegovina.

Figure 10.7. **Tax Administration: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

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Tax authorities' functions are well defined, though compliance and risk management units require building

As Table 10.4 shows, all the SEE economies have built frameworks that outline the functions and structure of their tax authorities.

Table 10.4. **Tax Administration Sub-Dimension: Administrative organisation indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Functions and organisation	3.0	3.0	3.0	3.0	3.0	1.5
Compliance assessment and risk management	3.0	0.0	3.0	3.0	3.0	3.5
Independence and transparency	0.0	0.0	0.0	0.0	0.0	0.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323457

Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro have a central tax authority that audits and collects taxes. Montenegro's tax system is structured by function (registration, declarations, audit, appeals, refunds, etc.), while Kosovo's is organised by functions and taxpayer group (e.g. large corporate taxpayers, SMEs, individuals). In Bosnia and Herzegovina, there is no overarching authority, with each entity administering taxation by function and taxpayer group.

Compliance assessment and risk management are well developed throughout the region, save in Bosnia and Herzegovina. The tax authorities in the other economies have set up audit divisions and large-taxpayer units. Legal frameworks to ensure procedural fairness in tax compliance rulings are also in place.

In Bosnia and Herzegovina, there is no tax audit division at the entity-level. In the absence of systematic procedures, risk assessment is random. The other five economies have instituted units to assess taxpayer compliance (including large taxpayers) and risk management. In the Former Yugoslav Republic of Macedonia, the General Tax Inspectorate operates an IT-based forensics laboratory for more efficient risk assessment. Montenegro, by contrast, seeks to identify different segments of the taxpayer population, including those prone to avoidance.

Tax authorities are seldom independent of the ministries of finance, which hold direct powers of taxation. The authorities in the SEE economies have been building their capacity to levy tax, which rose from EUR 7.3 per capita in 2010 to EUR 8.3 in 2014, – a gauge of the growing importance of tax administrators and the growing expenditure on administration. The increased spending is a sign that governments are investing in building up the tax authorities' capacity to carry out their duties and provide services that support compliance.

Tax authorities modernise filing and payment systems and services to ensure compliance

Economies from the region have started streamlining and modernising procedures by introducing e-filing and e-payment (Table 10.5). Yet procedures are still considered too complex and time-consuming.

Table 10.5. **Tax Administration Sub-Dimension: Taxpayer compliance indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Tax filing and payment procedures	2.0	2.0	3.0	3.0	2.0	2.0
Taxpayer services	2.0	1.0	3.0	2.5	2.5	1.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323466

Albania, Kosovo, the Former Yugoslav Republic of Macedonia and Serbia have all introduced mechanisms for electronically filing and paying certain taxes. Montenegro, too, has introduced electronic tax submission, though it appears to apply only to commercial entities for business-related taxes for the time being. Montenegro has additionally attempted to facilitate company registration in regional offices rather than only in the capital city of Podgorica.

Serbia, for its part, is introducing the electronic submission of income tax and social security contributions and is training taxpayers on how to use the service. As for Bosnia and Herzegovina, although it has sought to simplify the filing of returns and tax refunds, the government has yet to introduce electronic submission. The entities' tax agencies are fully capable of rolling out the e-filing of returns and are already using databases and web applications, though only for a few types of taxes. Albania and the Former Yugoslav Republic of Macedonia have made it compulsory to e-file returns on certain taxes – e.g. VAT, corporate income tax, personal income tax, and social and health insurance.

As regards taxpayers' access to information on compliance, the SEE experience varies. Most of the economies run websites that offer comprehensive taxpayer information, which typically includes instructions, legislation and legal decisions. In Serbia and Bosnia and Herzegovina, by contrast, there are worries over the quality of in-person and phone support, which raises wider concerns about the skills of tax officials and the need for proper training. In Montenegro, taxpayer services include educational units that advise citizens on tax compliance, while the only economies to have established a tax ombudsman's office are Albania and Kosovo.

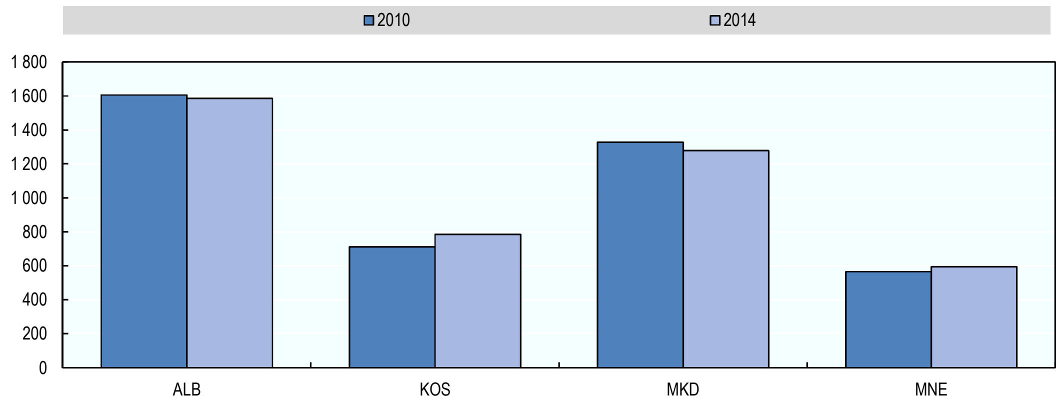
Tax administrations need to further build the capacity of tax authorities and upgrade the skills of staff, to provide better services to taxpayers. Kosovo and Montenegro have seen slight staff increases since 2010 and Albania and the Former Yugoslav Republic of Macedonia slight declines (Figure 10.8). Regular reviews of human resource management policies, staff numbers and skills levels are important to ensure that tax authorities are in a position to deliver on their mandates.

The way forward in corporate tax policy

As they look to the future, it is recommended that the SEE economies consider establishing legal frameworks to ensure procedural fairness in tax compliance rulings. The economies that have no audit unit in place to assess compliance and risk management would benefit from setting one up.

The SEE economies have room to further improve the autonomy of their tax authorities, which often is not a policy priority. The feasibility of providing increased autonomy to the tax authority from the Ministry of Finance deserves serious consideration, as do the legal provisions, statutory rules, organisational structure and operational policy freedom it would have.

Figure 10.8. **Number of staff employed in tax administration, 2010 and 2014**



Note: Data for Bosnia and Herzegovina and Serbia not available.

Source: National statistical sources.

StatLink http://dx.doi.org/10.1787/888933322293

As the SEE economies look ahead, they could continue to simplify tax return forms and payment procedures and make e-returns available for as many taxes as possible. To that end, it is important that taxpayers have all the information they need to utilise electronic filing and payment methods.

SEE economies would benefit from introducing legal provisions to ensure procedural fairness and equity in tax compliance rulings. Another positive move for economies that have no audit units in place for assessing compliance and risk management would be to introduce and develop them.

Tax Policy Analysis Sub-Dimension

Tax policy analysis aims to understand how different taxes contribute to total tax revenue (the tax mix), to analyse the economic effects and policy trade-offs of different taxes and incentives, and to estimate how tax revenues are likely to change when rates, or other parameters, change. Sound tax policy analysis that communicates its findings properly can reduce uncertainty over tax reforms and garner political support. It also helps to identify "winners" and "losers" of reforms. The statistical and analytical tools which economies use to assess their tax policies play an important part in informing and strengthening tax policy. The overall performances of the SEE economies in the Tax Policy Analysis Sub-Dimension are obtained by assessing how they fare against three indicators.

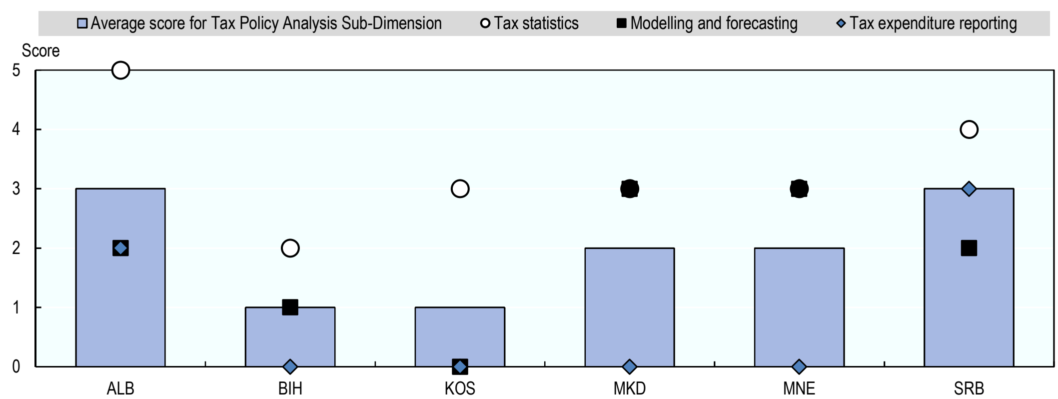
- The regular collection of **tax statistics** is critical to informed policy making. The tax statistics indicator assesses whether tax collection agencies routinely collect statistics on corporate taxation and whether the data are made publicly available and easily accessible. It also examines whether tax statistics are systematically fed into the policy-making process.
- **Modelling and forecasting** tools enable policy makers to estimate future tax revenues. They also need to identify the taxpayer groups who will be positively or adversely affected by a proposed reform and so decide whether it is desirable. To

that end micro-simulation models, which rely on taxpayer-level micro-data, are widely used.

- **Tax expenditure reporting** records what is, in effect, tax relief for certain activities or groups of taxpayers. Because it is public spending, though, it needs to be offset by higher taxes in another policy field. Tax expenditure therefore needs to be measured, reported and factored into national budgets.

There are considerable differences between the tax analysis capacities of the SEE economies (Figure 10.9). Albania and Serbia, for example, boast advanced policies. As for the Former Yugoslav Republic of Macedonia and Montenegro, they are now starting to implement tax analysis, while Bosnia and Herzegovina and Kosovo are still in the early stages of building their analytical capacities.

Figure 10.9. **Tax Policy Analysis: Sub-Dimension average scores and indicator scores**



Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933322306

SEE economies' tax agencies regularly collect tax statistics to help inform policy making

Most SEE economies have drafted the necessary legislation and built the institutional capacity to collect tax statistics (Figure 10.9).

Table 10.6. **Tax Policy Analysis Sub-Dimension: Tax statistics indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Tax statistics	5.0	2.0	3.0	3.0	3.0	4.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323472

The foundation of an economy's ability to carry out formal tax analysis is the regular collection of reliable tax statistics. The tax authorities in the region routinely collect statistics on corporate taxation and the data are publicly available and accessible. In Montenegro, the tax administration runs six statistical surveys on tax data collection. Albania, too, has a good statistics gathering capacity, with systematic co-operation between the general Directorate of Taxation and the Ministry of Finance on Tax Statistics. The Bosnia and Herzegovina Entity Tax Administration and Indirect Taxation Authority regularly collects statistics although it makes only some of them publicly available.

Despite strong statistics bases, the way they are used for effective tax analysis varies

Modelling and forecasting capacities vary, with the Former Yugoslav Republic of Macedonia and Montenegro having the strongest. In tax expenditure reporting, only Albania and Serbia have basic capacities in this area (Table 10.7).

Table 10.7. **Tax Policy Analysis Sub-Dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Modelling and forecasting	2.0	1.0	0.0	3.0	3.0	2.0
Tax expenditure reporting	2.0	0.0	0.0	0.0	0.0	3.0

Source: OECD assessment conducted in SEE economies (2015); see methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

StatLink http://dx.doi.org/10.1787/888933323487

SEE economies make use of aggregate tax revenue forecasting models for a few selected taxes. Kosovo, however, is currently working with the IMF on revenue forecasting and there is no indication that the Ministry of Finance has used modelling for any taxes. Bosnia and Herzegovina has a slightly better developed system, with aggregated tax revenue forecast models for indirect taxes only. Efforts are currently being made to further develop Bosnia and Herzegovina's modelling and forecasting capabilities. The Former Yugoslav Republic of Macedonia and Montenegro use tax revenue forecasting models for their main taxes and micro-simulation models (on an ad hoc basis in Montenegro) to assess the impact of taxation measures.

Tax expenditure reporting is an advanced analysis-based tax statistical method for which most of economies in the region lack capacity. Serbia and Albania, however, have designed tax expenditure reporting mechanisms and are now applying them. Serbia reports routinely and incorporates its reports in its annual budget. Serbia also participates in the Road to Europe – Programme of Accounting Reform and Institutional Strengthening (REPARIS). REPARIS helps countries to adapt laws and regulations that govern financial reporting and to develop the related institutions in line with EU requirements. Albania, for its part, performs tax expenditure reporting sporadically, usually when the fiscal package has been revised and new tax relief measures are introduced.

The way forward in tax analysis

As the SEE economies move forward, they would benefit from a number of measures to further develop their modelling and forecasting capacities. Kosovo's Ministry of Finance might well consider starting to apply aggregate tax revenue forecasting models. Bosnia and Herzegovina, too, could expand tax revenue forecasting to all main types of taxes. Indeed, it would be beneficial for all the SEE economies to use micro-simulation models for analysing the revenue impact of alternative tax regimes and carry out disaggregated analyses of their current tax regimes.

It is recommended that the SEE economies further build their tax authorities' capacity to report tax expenditure. Albania could try reporting tax expenditure on a routine basis and incorporating it into the budget. Serbia could begin monitoring its tax authority's tax expenditure reporting to evaluate its effectiveness.

Box 10.2. **Best practices for tax analysis and expenditure reporting**

With their numerous methodologies, tax analysis and tax expenditure reporting are highly complex. However, there is no single ideal methodology or system. Tax analysis often has to be country-specific, taking into account both the types of taxes which are administered and the capacity of the tax authority to carry out the analysis.

The report, entitled *Tax Expenditures in OECD countries,* published by the OECD (2010b) offers a series of cases studies of methods of tax analysis and expenditure reporting in different developed economies.

Examples include a number of OECD economies that carry out tax expenditure reporting for all or most of their taxes. The report describes the methodologies each economy uses. For example, the Japanese benchmark system of analysis offers a general, broader analysis of tax measures than other OECD countries. The report also provides information on how frequently countries publish their reports and how they incorporate tax expenditure reporting into their budget process.

Policy makers in South East Europe can utilise the case studies to examine methodologies and choose the one that best suits their environment.

Source: OECD (2010b), *Tax Expenditures in OECD Countries*, http://dx.doi.org/10.1787/9789264076907-en.

Conclusions

To conclude, SEE economies have made progress in reducing the complexity and costs of filing and paying taxes, introduced transfer pricing rules, and built initial tax analysis capacities. Furthermore, tax treaties have been signed and ratified throughout the region which has helped address issues of double taxation between SEE economies and with EU member states. These achievements have contributed to improving tax payment compliance and increasing tax revenues in the region.

Despite these achievements, SEE economies still face a number of challenges. They include the need to fully align tax incentives with the EU *acquis*, to further develop taxpayer services, to enhance the scope and quality of the resources of the relevant government bodies and to enhance tax filing and payment procedures, especially through e-filing. Governments should also consider working towards increasing the independence of the tax authorities and defining more clearly the implementation procedures of transfer pricing regulations.

Notes

1. A score of 0 denotes minimal policy development while a 5 indicates alignment with good practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a draft or pilot framework, 2 means the framework has been adopted, 3 that it is operational and that the budget is available accordingly, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic. For more information, please refer to the methodology and assessment process section in this *Competitiveness Outlook 2016* (p. 33).

2. Montenegro data are based on 2013 figures; information from Bosnia and Herzegovina and Serbia have not been made available.

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