
INDIRECT TAXES IN KOSOVO'S TAX SYSTEM: IMPACT ON BUSINESS ACTIVITIES WITH SPECIAL EMPHASIS ON VAT AND EXCISE CHANGES RATE

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Abstract: This study explores the role and significance of VAT (Value Added Tax) and excise duties in Kosovo's economy, considering the economy in the Republic of Kosovo and the impact that taxes have on the collection of public funds, this paper aims to assess how these fiscal policy changes have influenced economic activity, compliance, and business operations within the country.

This paper will provide evidence from research conducted earlier on the importance of taxes and excise in many different countries, including the Republic of Kosovo. The purpose of the study will be focused on the effects of several key changes: the increase in VAT from 16% to 18%, the reduction of VAT on essential consumer goods from 16% to 8%, the increase of VAT in the pharmaceutical sector from 0% to 8%, the implementation of a flat VAT rate for agricultural products, the reduction of the VAT threshold from €50,000 to €30,000, and the increase in excise duty on tobacco. Data are gathered through surveys conducted with businesses in Republic of Kosovo with close questions regarding the area of changes in taxes and excise, with the results processed using Stata to assess the impact of these changes. Fiscal policy is crucial for economic development, and this changes implemented by the Government of Kosovo have positively influenced overall state revenues. However, the increase in pharmaceutical products due to VAT changes has negatively affected consumers, while the increase in excise duty on tobacco has contributed to higher collected revenues.

The main limitation of this research is the availability of comprehensive data from relevant institutions in Kosovo, which may affect the depth of analysis. Also, although this study does not include all types of businesses, it is planned that future research will be more comprehensive, providing a more complete overview of business diversity in Kosovo. This research highlights the importance of fiscal policies in economic development and the need for the government to provide businesses with sufficient time and support to adjust to tax rate changes.

The study also underscores the varied impacts of VAT changes on different sectors, emphasizing the need to consider consumer welfare in tax policy decisions.

This study provides real data on the current situation of VAT and excise duties in Kosovo, from the business sector contributing valuable insights for policymakers and stakeholders, especially considering support for the private sector can lead to an overall increase in export levels and positively impact the economy as a whole.

Keywords: VAT, excise duty, fiscal policy.

1. INTRODUCTION

VAT collection is crucial to tax systems, generating approximately 20 percent of global revenue in over 160 countries (OECD). In Kosovo's economy, VAT and excise duties play a significant role in budget revenue collection. Following recommendations from the International Monetary Fund, the Government of Kosovo implemented fiscal changes in 2015. VAT contributes about 40% of Kosovo's total revenue (Ministry of Economy and Finance RK). Law no. 03/L-146, on Value Added Tax, approved by the Assembly of Kosovo in December 2009, establishes the Value Added Tax (VAT) system in the territory of the Republic of Kosovo. In Kosovo, the VAT rate was adjusted in 2015, increasing from 16% to 18%. Additionally, a reduced rate of 8% was introduced for certain goods and services, a decision made by the Government of Kosovo. These goods include salt, milk, cereals, and pharmaceuticals, among others. Notably, the VAT change impacted pharmaceuticals, which were previously exempt from VAT (0%) (Tax Administration of Kosovo, n.d.).

Only taxpayers registered as VAT declarants, either by surpassing the threshold of €30,000 or by voluntary registration, are authorized to collect VAT at the point of sale. Companies exceeding the €30,000 threshold must register for VAT and obtain a VAT certificate. In Kosovo, VAT is applied at two rates: 18% and 8%, except for exports which are zero-rated. (GAP Institute)

A taxable person is defined as an individual registered for VAT who engages in economic activities, either regularly or occasionally. According to the World Bank, tax revenues in Kosovo increased by 15% between 2014 and 2017,

largely due to VAT collected at the border. This paper will present the effect of changes in the tax system on business activities in the Republic of Kosovo.

The research hypotheses include the following

Hypothesis 1: The change in VAT in Kosovo has positively impacted business operations.

Hypothesis 2: The increase in excise duty on tobacco and alcoholic beverages has negatively affected sales.

2. LITERATURE REVIEW

Countries constantly seek sustainable economic growth, employing various policies to achieve this goal. One such policy is the Value Added Tax (VAT), which is often used to stimulate economic growth because its value is reflected in final products and services. VAT is a sales tax levied at each step of the production process. It is collected when goods or services are purchased throughout the production chain, from the initial purchase of raw materials to the sale of the final product at a retail outlet. In some countries, VAT is known as a "goods and services" tax (Kryeziu & Imeri, 2016).

The tax system is a key element of a country's economy, as the majority of budget revenue comes from tax collection. This paper emphasizes the fulfillment of tax obligations by citizens, aiming to increase state revenues. For manufacturers importing capital assets, VAT payment can be deferred for six months. In accordance with EU principles, the VAT for exports is zero percent. Kosovo, as a state emerging from conflict, underwent a particularly complex process concerning its economic and tax policies. The creation of the tax system in Kosovo by UNMIK was a unique case as it was implemented without consultation with Kosovars and lacked a thorough analysis (Peci, 2013). Also In their book, Samuelson and Nordhaus (2009) re-emphasized the role of indirect taxes such as VAT and other sales taxes in business activities because they directly affect the increase in production costs. These costs are transferred at each stage and are finally reflected in the final price.

According to Rexha, Bexheti, and Berisha (2021), the impact of direct and indirect taxes on economic growth is significant. Using an autoregressive model, their results show a positive and significant effect of indirect taxes on real GDP in Kosovo. Asllani, Grima, and Seychell (2020) find that the need for tax reforms in Kosovo should focus primarily on changes in tax collection, control management, and the reduction of the informal economy. However, the authors also emphasize the importance of border taxes and legal procedures.

Habani, Misiri, Kilaj, and Morina (2022) provide a summary of tax revenues in the Republic of Kosovo for the period 2010-2020. Their study found that the 2015 reforms had a positive impact on economic growth. Smajli (2015) concluded that the tax administration in Kosovo is tasked with collecting financial revenues to fund public expenditures, always aiming to raise awareness among businesses about fulfilling their tax obligations. However, compared to other countries, Kosovo has yet to establish a highly satisfactory tax system.

In a study by Shaqiri, Elshani, and Ahmeti (2024) on the types of tax revenues that drive economic growth in developed countries from 1995 to 2020, based on approximately 260 observations, it was found that economic growth is positively influenced by corporate income and taxes on specific goods. However, value-added tax (VAT) has negative effects on economic growth. Hakim et al. (2022) found that direct taxes have a positive impact in developed countries, whereas the opposite effect is observed in developing countries, where indirect taxes cause adverse effects in both types of countries. According to the (Mirrlees et al., 2011), the model of indirect taxes should function to equalize activities among businesses. While the tax burden may vary, the effect should consider the importance of the size of the given sector. This approach ensures that the tax is applied in a way that does not harm business activities.

Korkmaz and Korkmaz (2023) analyze taxes collected by the government, describing them as determinants of economic growth. Using Turkish economic data collected over quarterly periods, they demonstrated a long-term relationship in three models. It was concluded that in the Turkish economy, indirect taxes have a positive role, while corporate taxes have a negative impact. Indirect taxes influence business decisions regarding investment and expansion. Higher costs from taxes on inputs and services may reduce competitiveness and profitability (OECD,2018).

3. MATERIALS AND METHODS

This research utilized a survey technique, with a questionnaire serving as the primary measuring instrument. Conducted in July 2023, the survey targeted 50 manufacturing and commercial businesses, primarily from the Gjilan and Ferizaj regions. The businesses were given closed-ended questions with alternative answers to ensure clarity and ease of analysis. The addresses of the businesses were obtained through the Kosovo Business Registration Agency (ARBK) and the official websites of the enterprises. The survey achieved a return rate of 29%.

4. RESULTS AND DISCUSSIONS

In the table below, we present the types of businesses that participated in our survey. According to the results, 16% of respondents identified as producers, while 9% were engaged in trade

Table 1. Type of businesses of the participants

Valid		Frequency	percent	Valid percentage	Cumulative percentage
	a)Producer	18	9.0	9.0	16.0
	b)Trade	32	16.0	16.0	25.0
	Total	50	25.0	25.0	

Source: STATA Author's Calculation

Table 2.Average and standard deviation

	N	average	Standard Deviation
1. To the question, has the increase in the VAT rate, from 16% to 18%, affected the business of your business?	50	2.88	1.14
2. How did the reduction of the VAT rate for the essential items of the consumer's basket from 16% to 8% affect?	50	1.97	2.25
3. What impact does the reverse VAT charge have on construction companies?	50	1.75	.721
4. The flat rate of VAT on agricultural products, how has it affected commercial enterprises?	50	2.60	.511
5. Has the increase in the VAT rate of medicines from 0% to 8% affected the general business?	50	1.61	.517
6. Has the release of VAT affected the import of raw materials for manufacturing businesses?	50	1.57	.496
7. What is the impact of lowering the VAT threshold from €50,000.00 to €30,000.00	50	1.79	.720
8. How did the increase in excise duty on cigarettes affect your business?	50	1.20	.811
9. Has the excise tax affected the sale of alcoholic beverages?	50	1.81	.738
10 Has higher excise duty on goods with negative impacts on the environment affected your business? .	50	2.76	1.71
Valid N (list)	50		

Source: STATA Author's Calculation

Table 3. Effect of changing in VAT from 16% to 18%

Questions	Frequency	Percent
To the question, has the increase in the VAT rate, from 16% to 18%, affected the activity of your business?	N	%
<i>a) Yes affect</i>	35	70.0
<i>b) No it didn't</i>	15	30.0
How did the reduction of the VAT rate for the essential items of the consumer's basket from 16% to 8% affect?	N	%
<i>a) Positively</i>	50	100.0
<i>b) Negatively</i>	0	0.0
What impact does the reverse VAT charge have on construction companies?	N	%
<i>a) Positively</i>	10	20.0
<i>b) Negatively</i>	30	60.0
<i>d) None</i>	10	20.0

Source: STATA Author's Calculation

With an average score of M=2.88, it is evident that the increase in the VAT rate has impacted business activities by directly influencing price increases. Out of the 50 businesses surveyed, 35 reported that the VAT increase had an impact, while 15 indicated no impact from the change in the VAT rate.

Regarding the reduction of the VAT rate for essential consumer basket items from 16% to 8%, businesses were asked how this change affected them. Despite the expectation that reducing the VAT rate on essential food items would lower prices, this effect has not been significantly observed, and it has had minimal impact on boosting consumption. However, with an average score of M=1.97, there has been a positive impact on businesses, with all 50 respondents indicating that the reduction has had a favorable effect.

On the question of the impact of the reverse charge on VAT in construction companies, the average score of M=1.75 suggests a predominantly negative impact. Many construction companies reported that the reverse charge, particularly on purchases related to housing construction, adversely affected them. Under this system, investors had to pay VAT on purchases, but could not include VAT in the selling price of apartments, as apartments are exempt from VAT under the law. This situation was detrimental to investors. It is important to note that a regulatory change effective from January 1, 2020, now exempts the reverse charge for investor-employee relationships, applying it only to subcontractors. This adjustment was made in response to strong advocacy from the business community.

Table 4. Effect of changing in VAT in medicine and threshold

Questions	Frequency	Percent
Has the increase in the VAT rate of medicines from 0% to 8% affected the general business?	N	%
<i>a) Yes affect</i>	40	80.0
<i>b) No it didn't</i>	10	20.0
Has the release of VAT affected the import of raw materials for manufacturing businesses?	N	%
<i>a) Yes affect</i>	45	90.0
<i>b) No it didn't</i>	5	10.0
What is the impact of lowering the VAT threshold from €50,000.00 to €30,000.00?	N	%
<i>a) Positively</i>	0	0.0
<i>b) Negatively</i>	38	76.0
<i>d) None</i>	12	24.0

Source: STATA Author's Calculation

The increase in the VAT rate on medicines from 0% to 8% has significantly impacted the general business environment. Out of the 50 businesses surveyed, 40 indicated that this change has led to higher medicine prices, which in turn has strained consumers financially. This sentiment is reflected by an average score of $M=1.61$.

The VAT exemption on the import of raw materials for manufacturing businesses has had a positive effect. Among the 50 businesses surveyed, 45 responded that this exemption has positively impacted their operations, while only 5 reported no impact. The significant effect on manufacturers who utilize this VAT law provision is further supported by an increase in the standard deviation to 496.

Most businesses expressed disapproval of the reduction in the VAT threshold due to its complexity and the additional burden of maintaining records. This sentiment is illustrated by an average score of $M=1.79$, with 38 out of 50 businesses indicating that the impact has been negative. The specifics and psychological aspects of this change contribute to their preference against the threshold reduction.

Table 5. Effect of changing in Excise

Questions	Frequency	Percent
How did the increase in excise duty on cigarettes affect your business?	N	%
<i>a) Positively</i>	0	0.0
<i>b) Negatively</i>	10	20.0
<i>d) None</i>	40	80.0
Has the excise tax affected the sale of alcoholic beverages?	N	%
<i>a) Yes affect</i>	40	80.0
<i>b) No it didn't</i>	10	20.0
Has the higher excise duty on goods with negative impacts on the environment affected your business?	N	%
<i>a) Positively</i>	5	10.0
<i>b) Negatively</i>	35	70.0
<i>d) None</i>	5	10.0

Source: STATA Author's Calculation

The increase in excise duty on cigarettes has raised their prices; however, sales have remained steady, with no significant decrease observed.

Similarly, the increase in excise tax on alcoholic beverages has directly impacted their selling prices. Despite this increase, businesses have reported only slight reductions in sales. An average score of $M=1.81$ indicates that out of 50 businesses, 40 stated that the excise tax has had an impact on their sales.

Additionally, the higher excise duty on goods with negative environmental impacts has affected businesses by increasing the prices of these items. With an average score of $M=2.76$, it is clear that this price increase has had a notable impact on business operations

Table 6. The correlation between the impact of VAT and the reduction of the VAT rate

	Has the increase in the VAT rate, from 16% to 18%, affected your business operations?	How did the reduction of the VAT rate for the essential items of the consumer basket from 16% to 8% affect?
Has the increase in the VAT rate, from 16% to 18%, affected your business operations?	Pearson Correlation 1	.002
	Sig. (2-tailed)	.782
	N	200
How did the reduction of the VAT rate for the essential items of the consumer basket from 16% to 8% affect?	Pearson Correlation .002	1
	Sig. (2-tailed)	.782
	N	200

Source: STATA Author's Calculation

In order to test the first hypothesis of this study: " The change in VAT in Kosovo has positively impacted business operations.", the correlation was made. The Pearson correlation results show that there is a positive relationship between the impact of VAT and the reduction of the VAT rate, and this relationship is statistically significant [$r=.002$ and $p=.782$].

Table7. Correlation between the increase in excise duty on cigarettes and alcoholic beverages

		How did the increase in excise duty on cigarettes affect your business?	Has the excise tax affected the sale of alcoholic beverages?
How did the increase in excise duty on cigarettes affect your business?	Pearson's correlation	1	.004
	Significance		.283
	N	200	200
Has the excise tax affected the sale of alcoholic beverages?	Pearson's correlation	.004	1
	Significance	.283	
	N	200	200

Source: STATA Author's Calculation

To test the second hypothesis of this study: " The increase in excise duty on tobacco and alcoholic beverages has negatively affected sales ", a correlation analysis was made. The results of Pearson's correlation show that between the increase in excise duty on tobacco and alcoholic beverages, there is a positive correlation and this correlation is statistically significant [$r=.004$ and $p=.283$].

5. CONCLUSION

The reduction in the VAT rate from 16% to 8% has had a generally positive impact on Kosovo's economy. This change has particularly helped combat informality by encouraging more businesses to declare VAT, thereby broadening the tax base. VAT, as an efficient tax, has been favorable for businesses by reducing the overall tax burden and potentially increasing compliance.

However, the reform has not been without drawbacks. The increase in drug prices has negatively affected consumers, highlighting that tax changes can have varied effects across different sectors.

Additionally, excise duty, a fixed tax imposed on specific products, has played a significant role in revenue generation. Notably, the increased excise duty on tobacco has led to higher collected revenues, demonstrating the effectiveness of excise duties in certain areas.

It is crucial that tax reforms in Kosovo align with European Union regulations to ensure consistency and integration with broader economic policies. When implementing changes in tax rates, the government must provide sufficient time and support for businesses to financially adjust, as they often bear the brunt of such adjustments.

Overall, while the reduction in VAT has had positive outcomes, a balanced approach that considers the diverse impacts on different sectors and aligns with international standards is essential for sustainable economic growth.

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