

Tax Reforms in the Balkan Countries – Kosova Case

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Abstract

Today, when from the start of transition process in the Balkan countries about 19 years have passed, the reformation of their taxation systems is still ongoing, facing numerous challenges. The reforms of taxation systems is one of the most important components (segments) of their social-economic transition led by the aspiration to become members of the European Union. Higher results consist in the fact that all the Balkan countries, some earlier some later, have included the income tax,, the corporation income tax and the VAT into their taxation systems. In this context, in order to create competitive taxation systems to attract investments and to make taxation harmonizations with the EU, the tax rates have considerably been reduced and succesful steps have been taken in the function of harmonization of taxes with the EU member countries. Some countries have managed to build their taxation systems in accordance with *acquis communautaire*. The creation of taxation system and policy in Kosova by UNMIK is a case of a unique example created in practice without internal influence and without a political dialogue. From 1999 until the Declaration of Independence, on 17 February 2008, UNMIK was the creator of the taxation system and policies in Kosova. After the Declaration of Independence, the Government of the Republic of Kosova took the first reformation step by reducing the income and corporation income tax rates. However, the taxation system and policies in Kosova must also be reformed in many other components.

Keywords: reform, taxation system, transition, Balkan countries, harmonization, tax structure, etc.

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1. Introduction

After the fall of communist systems in the Balkan countries, in quite specific circumstances, the process of reformation of taxation systems within the framework of the social-economic transition started as a whole. Transition as a concept is a transforming process of deep dimensions of a social-economic system, by means of which this system passes into a new structure, which provides a higher efficiency and effectiveness. Thus, the Balkan states, in order to achieve these performances, had to make changes in all their subsystems of the social-economic system, in the first place in the political system, in the economic system, in the education system, etc.

Based on this, the transitional measures of the economic policy in these countries, in general, were, first of all, directed to liberalization of prices and market, public finance sustainability (stability) and development (tax and budget reforms), currency credibility, enterprise restructuring, enterprise privatization, creation of social insurance network and market oriented economies, legal and institutional framework development, etc. However, in order to remain faithful to the analysis object of this work (research, study), we shall, in the following, focus only on the taxation reforms in the selected Balkan countries: Albania, Bulgaria, Croatia, Macedonia, Romania, and laying a special emphasis on Kosova.

When in the early 90s the transition process in the European Southeastern countries began, the economic sciences were not so familiar with such practices of taxation reforms, which would help the bearers of economic policies. Gradually and upon becoming familiar with the first experiences of some countries in transition, many scientists got down to the analyses of taxation reforms processes.

It has to be emphasized that the property changes, the building of democratic institutions, the problem of economic sustainability and of monetary policy have more been an object of analyses and discussions than taxation reforms.

The reformation of taxation systems constituted only one of the main components of the reforming process within the social-economic transition. An analysis of the process of taxation reforms

in the Balkan countries was accompanied (followed) not by little difficulties for different authors, not excluding from this environment the author of this work either. On this occasion, from my part, I would separate/highlight the following:

Firstly, that a complete and sustainable analysis is to be based on reliable facts from a reliable source, taking into account the nature of cases of reform studies in some countries and the long period of their time extension. The problem with reliable data has particularly been expressed in the first years of transition in all the Balkan countries and it still continues to be true.

In the case of Kosova, the lack of a national office of statistical data of economic indicators was a big problem, which also had direct effects on the taxation reform. The creation of the fiscal policy by UNMIK was done in quite specific conditions in comparison with other countries. This is due to the fact that the fiscal charge was applied in the absence of an economic development strategy, as well as in the absence of definition and formulation of a long-term consistent fiscal policy. This absence was as a result of non-definition of the political status of Kosova and of a *sui generis* model of administration by UNMIK, which applied the fiscal policy only in the function of accomplishment of fiscal objectives. Thus, the fiscal charge in Kosova was applied by UNMIK in the absence of a real determination of macro-economic factors, such as GDP, per capita income, etc.

Kosova does not yet have a real statistical office for the determination of macroeconomic and other relevant indicators for the formulation and implementation of the fiscal policy. The analyses of macroeconomic performances of Kosova are limited due to a very poor statistical base and frequent changes in the evaluation of macroeconomic processes by the local and international institutions. In 2005, for example, the participation of the budget income in GDP was evaluated at 25%.

These evaluations differ from those of the previous years. Thus, the IMF mission in its April-May 2005 report evaluated the GDP for 2005 in the amount of €2,433 million, whereas the one for 2004 in €2,516 million, or for 21.7% higher than it had evaluated it in December (€1,999 million). The change/difference was not the result of reduction of expenditure or budget income, but the result of new

evaluations on the GDP level by the IMF.¹ To bring into evidence these oscillations in different evaluations of macroeconomic indicators, while drafting this analysis, we focused ourselves on the presentation of data on budget income (revenues) according to financial data for 2004, according to local and international financial institutions. Thus, the budget revenues, according to financial reviews for 2004² by the Ministry of Economy and Finance (MEF), were 602.45, according to the Monthly Macroeconomic Monitor of the Ministry of Economy and Finances³, they were 635.00, according to the International Monetary Fund⁴ they were 601.30, whilst according to the World Bank⁵ they were 610.90.

Very great oscillations in evaluation of GDP and other indicators make the real evaluation of tax charge impossible, etc. As a consequence, all of this makes it impossible, at the very beginning of a tax form application, to anticipate accurately the fiscal, social and economic repercussions that they cause and since the beginning the accomplishment of the law (righteousness) principle in tax becomes impossible. Therefore, we consider that the taxation system of Kosova consists of tax forms not sufficiently linked with a common long-term and development idea. The tax forms consisting it, have limited and not well harmonized functions with each other. This influences the results of tax income gathering to be chronical and not in the rhythm with the needs of economic stimulation and development of Kosova. Therefore, an urgent need for the creation of a sustainable basis of macroeconomic data and a permanent accounting system arises, in order to

¹ Research report: Fiscal culture and budget sustainability (Raport hulumtues: Kultura fiskale dhe qëndrueshmëria buxhetore), Prishtinë 2005: *Riinvest and Forum* 2015, p. 8.

² MEF, "Pasqyrat financiare për vitin 2004" (Departamenti i Thesarit, 2005).

³ MEF Monthly Macroeconomic Monitor Kosova, July 2005.

⁴ IMF/FMN, Aide Memoire, of the IMF Staff Mission to Kosova, 14-25 July 2005.

⁵ Banka Botërore, "Rishqyrtimi i Shpenzimeve Publike dhe i Institucioneve në Kosovë", 22 qershor 2005. (World Bank, "Review of Public and Institutional Expenditure in Kosovo", 22 June 2005).

create sustainable indicators for building macroeconomic policies.

In the present analysis, in order to treat taxation reforms of the selected Balkan countries, we have used statistical data of the IMF, World Bank, Mitra, Pradeep & Nicholas Stern, *Taxation Systems in Transition*, World Bank Policy Research Working Paper 2947, January 2003, Lorie, Henri, *Priorities for Further Fiscal Reforms in the Commonwealth of Independent States*, the IMF Working Paper WP/03/209, cited in the brilliant report by Grabowski M., Tomalak M., *Taxation reforms in the countries of the Central Europe and the Commonwealth of Independent States*, [w:] *New Europe - Report on Transformation*, Instytut Studiów Wschodnich, Warsaw 2004. We have analyzed the case of Kosova on the basis of reports of the IMF, World Bank, reports of the Ministry of Economy and Finance, as well as other secondary sources.

Secondly, that the transition process from a centralized economy plan to market economy was accompanied with a great growth of the informal economy sector, which could never be covered by statistics. In the case of Kosova, the informal economy sector is a *terra nullius (waste land)* in the sense of institutional recognition and measurements. No one has so far made a real statistical analysis.

Thirdly, that the public sector width, which includes a great number of data in itself, is difficult to compare and harmonize for study cases. Often, these data differ from an institution to another, within a country, all the more within countries..

The present analysis consists of four parts. In the first part the taxation reforms background in Balkan countries and in Kosova is presented. The second part contains a comparative analysis of the income structure from different sources of income in the historical context, highlighting the most important changes to the present day, and the case of tax structure in Kosova. In the third part, we have treated taxation reform trends in the selected Balkan countries with special emphasis on the case of Kosova, whilst in the fourth part the tax harmonization, as a motive and trend of taxation reforms in the Balkan countries, has been analyzed. The analysis ends with a summary of conclusions and recommendations.

II. Taxation Reforms Background in the Balkan Countries and Kosova

The designing of an appropriate and functional taxation reform has not been an easy objective to be reached in any of the Balkan countries. Difficulties have especially arisen in making the reforms acceptable and then successfully implementable. The taxation reforms management has been during the whole taxation reform process, from the inspection of the state until now, a long and complicated process and it still continues to be. This is due to the fact that all post-communist countries possessed taxation systems drafted for the planned economy and incompatible with the market economy and with a tax administration which needed a complete reorganization for the purpose of a successful operation in new conditions.⁶

The economic transition brought new and unique challenges to the Balkan countries. Some of them we have treated here below (in the following):

1) In the '90s, the taxation systems of post-communist countries are characteristic for: a) non-transparency, b) differences in tax charges by means of which the discrimination of certain activities and factors and at the same time favoring of the others was done; c) there was no balance between direct and indirect taxes; d) the frequent changes in taxation systems and in certain taxes (especially on the turnover rates) as a

⁶ Grabowski M., Tomalak M., "Taxation System Reforms in the Countries of the Central Europe and CIS", *New Europe - Report on Transformation*, Instytut Studiów Wschodni, Warsaw 2004, p. 251-301; Fischer, Stanley and Ratna Sahay, "The Transition Economies After Ten Years," in: Orłowski, Lucjan T. (ed.) *Transition and Growth in Post-communist Countries: The Ten-year Experience*, Cheltenham, UK and Northampton, MA, USA : Edward Elgar. 2001, p. 3-47; Rigger Nord, "Central and Eastern Europe and the New Financial Architecture" op. cit. pp.1-6; Dabrowski, M. and Radziwill, A., "International Public Goods for Economic Development: the Case of Post Communist Transition" *Paper Prepared for the Conference on 'International Public Goods for Economic Development'*, Weatherhead Center for International Affairs, Harvard University, September 7-8, 2005, p. 8; Bruno S. Sergi, "The Balkans Jump on the Tax Rivalry Bandwagon", *SEER-South -East Europe Review for Labour and Social Affairs*), Brussels, issue:01/2005, pp. 7-18; Available on: www.ceeol.com f. 7-18.

consequence of an unsustainable tax policy; e) complex administrative procedures; f) incompatibility with the tax systems of West European countries; g) non-flexibility and non-simplicity.⁷

2) An indispensable condition (*conditio sine qua non*) for each tax reform was the tax administration organization. The tax income (revenues) that these countries generated in the past did not indicate what to collect in the future. The incomes were mainly transfers from some public sectors, mainly from state owned enterprises. The taxpayers number (state owned enterprises) was only in thousands and they were easy to be controlled.

The transformation of these economies brought (1) an increase of taxpayers number from thousands to millions, (2) by the liberalization of prices and increase of goods turnover, the possibility for tax administration information was limited (reduced), (3) the stimulation of services and activity of small enterprises caused an increase of total income (revenues), which was difficult to be taxed by the tax administration.⁸ These were only some of the causes that made that almost all the countries in transition to start the real organization of tax administration.⁹ In this context, in the Balkan countries too, the reorganization of tax administration was carried out within the Ministry of Finances and this process is till ongoing.

In the process of tax administration organization, an important place had to be given to the preparation of tax reviewers, intensifying taxpayers, taxpayers assistance, etc.

3) The lack of clear economic strategies. In none of the Balkan country was there a clear institutional strategy for the

⁷ About the details of taxation reforms in a wider context, respectively more widely, see: Vito Tanzi., *Fiscal Policies in Economies in Transition*: (Washington: IMF) 2002, chapters 5-11.

⁸ Vito Tanzi, "Financial Markets and Public Finance in Transformation Process" in Vito Tanzi (ed) *Transition to Market: Studies in Fiscal Reform*, op. cit., p. 18.

⁹ About the tax administration organization, more broadly, see: Kasanegra de Jantscher, Milka, Carlos Silvani and Charles L. Wehorn., "Modernizing Tax Administration", in ed. by Vito Tanzi, *Fiscal Policies in Economies in Transition*, op. cit., p. 120-141.

transition process. The more the economies of these countries were centralized, the more difficult was the choice of the institutional system based on which tax reforms would be conducted.

4) A similar situation in the tendency for the harmonization of their tax systems with the European Union countries (EU). All the Balkan countries have expressed their aspirations for membership in the EU. This was the reason why the Balkan countries have implemented VAT in their tax systems, the corporation income tax with accounting standards, income tax, customs tariffs ad valorem and excise tax.

5) Tax competition. In this sense the situation was challenging for the Balkan countries. The need of the Balkan countries for investments by foreign investors required the necessity of a competitive approach in designing their tax policies taking always into account (consideration) the importance that the tax policies have in attracting foreign investments through facilities and low tax rates.

6) Low tax education. The countries in transition have operated in environments where the tax payment in the society was not accepted as a kind and usual thing. This was the reason why the evasion was so high.

III. Changes in the Income Structure of the General Government Sector in Transition Period in the Balkan Countries and the Case of Kosova

The countries in transition have applied different tax forms as far as the selection of their tax structure is concerned. Countries with higher *per capita* income and with a more developed tax administration have a tax structure resembling more to the European Union countries. This was a result of the efforts of these countries to become the EU members through the harmonization of their tax systems, whereas countries with lower income (revenues) and with a poorer tax administration have built their tax structure on the basis of indirect taxes.

Before the start of the transition process, the income (revenues) of general government sector of the Balkan countries

were mainly based on incomes (revenues) from public sectors. With the start of the transition process, the role of state was limited in the redistribution of the income and this had an impact in reduction of participation of general government sector in GDP with an average decrease of 2.2% in the Balkan countries for the period 1991-2002 (see Table 1). This was as a consequence of privatization process of the state owned property and reduction of state activity in many basic functions. Other factors that have influenced the reduction of income participation of the general government sector in GDP are poor effects of tax administration in new circumstances and the increased fiscal evasion.

General government sector income participation in GDP in the Balkan countries

(Table 1)

Countries	1991 - 1995 % in GDP	1999 - 2002 % in GDP	3 - 2 % in GDP
1	2	3	4
Balkan countries	36.8	34.6	- 2.2
Albania	24.6	21.9	- 2.7
Bulgaria	37.8	41.3	3.5
Croatia	42.5	41.3	- 1.2
Macedonia	38.1	36.1	- 2.0
Romania	40.8	32.4	- 8.4

Source: International Monetary Fund, World Bank, Mitra, Pradeep & Nicholas Stern, "Tax Systems in Transition", World Bank Policy Research Working Paper 2947, January 2003, Lorie, Henri, "Priorities for Further Fiscal Reforms in the Commonwealth of Independent States", IMF Working Paper WP/03/209, -quoted by Grabowski M, Tomalak, opt. cit. f. 261.

From the table, one can see that the lowest participation in GDP from 1991 to 2002 of the governmental sector was in Albania, with 21.9%. On the other hand, if the tax and non-tax income participation in the income of the general governmental sector is viewed, it can be seen that the highest non-tax income participation was in Bulgaria, with 26.1%, whilst the lowest was in Croatia, with only 4.9% (see table 2)

Tax and non tax income participation in the total income of the general governmental sector of Balkan countries in 1999-2002

(Table 2)

Countries	Tax income in % in total revenues	Non-tax income in % in total income (revenues)
Balkan countries	86.2	13.8
Albania	82.2	17.8
Bulgaria	73.9	26.1
Croatia	95.1	4.9
Macedonia	89.8	10.2
Romania	94	6.0

Source: *ibid*, p. 264.

On the other hand, if one looks at the tax income structure in the general tax incomes in the Balkan countries in the transition period, one may see that the indirect tax income participated with 40% in the total income taxes (see Table 3). In this context Albania, Bulgaria and Croatia had the highest participation of indirect taxes.

Income taxes structure in the general governmental sector in Balkan countries in 1999–2002

(Table 3)

Countries	Taxes in total	Income taxes	Indirect taxes	Social welfare/security contributions	Other taxes
Balkan countries	100	19.2	40.5	29.8	10.4
Albania	100	13.1	44.8	20.3	21.8
Bulgaria	100	24.8	41.1	25.7	8.4
Croatia	100	10.9	46.9	34.1	8.1
Macedonia	100	18.4	35.6	33.3	12.7
Romania	100	25.6	34.3	35.8	4.3

Source: *ibid*, p. 267.

On the other hand, if we refer to the tax income participation, more accurately to the main tax forms in GDP, we shall see that their lowest participation was in Albania, under 20% of GDP (see Table 4). In this context, the lowest

participation was marked by income tax with around 1%. Croatia marked the highest participation of income tax in GDP, with more than 39%.

Tax income in relation to GDP in Balkan countries in 1999-2002

(Table 4)

Countries	Total	Income tax	Corporation income tax	VAT	Excises	Contributions	Customs	Property tax	Other
Balkan countries	29.3	3.1	1.7	7.9	3.7	9.4	2.1	0.1	1.4
Albania	18	0.8	1.6	6.5	1.6	3.7	2.4	0	1.4
Bulgaria	28.7	3.6	2.5	8.3	3.7	7.8	0.7	0	2.1
Croatia	39.3	2.9	1.4	13.9	4.5	13.4	2.7	0.2	0.3
Macedonia	32.4	4.8	1.2	6.1	5.2	10.8	3.7	0.5	0.1
Romania	28.2	3.3	1.9	4.5	3.5	11.2	0.8	0	3.0

Source: *ibid*, p. 271.

In the absence of statistical data, we could unfortunately not find the Kosova tax structure case in the above comparative analyses. Therefore, we have treated the Kosova tax structure case separately, but always with the purpose of comparison with other above-analyzed countries. For the purpose of analyzing the development of Kosova tax structure, we have analyzed it for the years 1999, 2000 and 2007.

In the last three years, the consolidated budget of Kosova was generated completely from its own source revenues. Budgetary revenues have increased from €249 million, or 23,4% of GDP, in 2000 to €616 million, or 32,5% of GDP, in 2004¹⁰. The participation of income tax in GDP in 2006 - 22.8%, in 2007 - 26.4%, in 2008 - 23.3%.¹¹

From the analysis of tax forms that existed in the period September-December 1999, the indirect income tax has in general prevailed (see table 5).

¹⁰ Banka Botërore: Raporti nr. 32624-XK, (World Bank, Report No. 32624-XK), Rishqyrtimi i Shpenzimeve Publike dhe i Institucioneve në Kosovë, 22 qershor 2005. (Review of Public and Institutional Expenditures in Kosova, 22 June 2005.)

¹¹ Department of Macroeconomy, Treasure - MEF.

*Tax structure September – December 1999**(Table 5)*

	Evaluation (in mil. DM)	Accomplishment
Total income	47.7	30.5
Customs	9.3	9.0
Excises	14.7	1.6
Sales tax	23.6	19.5

Source: Tax income report September - December 1999. Central Fiscal Authority (CFA).

The above data show that since the introduction in function of the first tax forms until the end of 1999, customs tariffs and sales tax on the border were levied satisfactorily, but unfortunately the excise levy was low. The total income collected by the end of 1999 reached 30.5 million DEM, despite the estimated 47.7 million DEM, in the budget¹². The failure in levying excises was related to incomplete coverage of the border with customs and to poor capacities of tax administration.

The number of taxpayers in 1999, who have fulfilled their duties, was quite small in comparison to the real number of those who had to fulfill their duties. This was a result of the failure to approve the Regulation on Tax Administration and Procedure that year.¹³ With the approval of this regulation the legalization of tax administration was done, enabling it, in cases of failure to fulfill the tax duty, to take measures for forced tax levying.

With the increase of expenditure in 2000, the need for new budget estimates, as well as for higher income for the funding of the increasing public expenditure increased.

¹² Raporti i Bankës Botërore: Kosova, reforma ekonomike e shoqërore për paqe dhe pajtim, Prishtinë, (World Bank Report, Kosova economic and social reform for peace and reconciliation) - 2000, p. 3.

¹³ UNMIK Regulation No. 2000/ 20 on Tax administration and procedures.

Tax revenue evaluated according to the consolidated budget for 2000 and tax revenue generated in the period 7 January – 31 December 2000

(Table 6)

Income (revenue)	Estimated		Realized (Accomplished)	
	Amount	%	Amount	%
Customs	38,000,000	19.10	60,518,805	25,73
Excises	21,000,000	10.55	38,170,574	16,23
Sales tax	104,000,000	52.26	123,995,807	52,73
Hotel and food tax	11,000,000	5.53	3,224,477	1,37
Anticipated tax			9,214,647	3,91
Tax on profit	5,000,000	2.51		
Wage tax	15,000,000	7.54		
Small business tax	5,000,000	2.51		
Total taxes	199,000,000	100	235,124,310	100

Source: Central Fiscal Authority (CFA).

From the above (Table 6), it can be seen that from the sales tax that was levied on the border, from customs and excises, more than 94% of the total tax income was levied. During 2000 the profit and wage taxes were anticipated, which were applied later. According to data on tax collection to 31 December, it can be seen that they exceeded the estimates for the whole year. Only tax on hotels and foods lacks behind, a tax from which the accomplishment is lower than the estimates. This income (revenue) would be much higher, had a series of factors not influenced as a source of fiscal evasion, such as: a) not full coverage of border crossing points in Kosova, b) high level of customs and excises on imported goods for business influencing the taxpayers evade in different forms the tax paying, c) recognition by UNMIK of preferential trade regime between FRY and FYROM in the territory of Kosova with tariffs as high as 1% of the goods value making it possible to enter Kosova goods with falsified certificates of Macedonian origin, e) lack of relevant legal regulations for many of business activity issues reflecting on hiding the tax basis, in the absence of business records, failure to identify tax entities, etc. All of these resulted to tax paying evasion.

From the tax structure analysis, respectively of participation of tax forms in the total tax income, it results that we had the same report of direct and indirect tax participation in 2007 the same as in

the forerunning (previous) years. This shows that the main objective of fiscal policy was the fiscal functions accomplishment, respectively the collection of anticipated budget funds, disregarding other functions of fiscal policy, such as the economic, social ones, etc.

Estimated tax income (revenue) according to the consolidated budget for 2007 and tax income accomplished for the period 1 January – 31 December 2007

(Table 7)

Total budget of Kosova 2007	Estimated ¹⁴	Accomplished ¹⁵	% of accomplishment	
Total income (revenue)	682.8	894.22	130.96%	
Central budget revenue (income)	654.8	789.99	120.65%	
<u>Tax income</u>	<u>578</u>	<u>711.09</u>	123.03%	79.52%
<u>Internal tax income</u>	<u>140.2</u>	<u>180.49</u>	128.74%	25.38%
<u>Border tax income</u>	<u>437.8</u>	<u>530.6</u>	121.20%	74.62%
<u>Non-tax income</u>	<u>40.8</u>	<u>53.2</u>	130.39%	

From the data on table for 2007, it can be seen that the tax system and policy that year relied on indirect tax basis as well. More than 74.62% of tax income was collected from border taxes, customs, VAT and excises. Despite many declarations of fiscal policy creators about the balancing of indirect and direct taxes, this still seems far in the prospective, as only 25.3% of the income was collected from internal taxes, respectively from direct taxes. This was very clearly specified in the last report of the European Commission¹⁶, which, referring to the tax system, says that there was a lack of progress.

¹⁴ Libri mbi buxhetin e vitit 2007, Ministria e Ekonomisë dhe Financave (The book on the budget of 2007, Ministry of Economy and Finances), 2007. p. 176.

¹⁵ Pasqyrat financiare mbi realizimet buxhetore për vitin 2007, Ministria e Ekonomisë dhe Financave 2008.

¹⁶ The Commission of the European Communities; Commission Staff Working Document – Kosova (UNDER UNSCR 1244/99) 2008 Progress Report, accompanying the Communication from the Commission to the European Parliament and the Council – Enlargement strategy and main Challenges 2008-2009, COM(2008)674, p. 35-36.

IV. Tax Reforms in Selected Balkan Countries and the Case of Kosova

The Balkan states, in distinction to other European countries, made the economic transition, including tax reforms, under the influence of quite specific political factors and circumstances. In this context, two things were the most determining: military conflicts that had captured these countries and the lack of a near prospective (prospect) for adhering to the EU in those years. Here should be specified Kosova and Bosnia and Hercegovina, where the political situation influenced directly designation of the tax system and policy.

Every Balkan country, involved in making a tax reform, went through a special path, different from another country. Each tax reform in each country, therefore, bore in itself certain features. However, the trends were common. In this context, all the Balkan countries in different years applied VAT, corporate income tax, and personal income tax in their tax systems.

In the process of tax systems reformation, among other things, two trends should be distinguished - a) the trend of reduction of the main tax rates with a special emphasis on corporate income tax, and b) the aspirations and acts of all the Balkan countries for membership in the EU, making the adoption of EU rules.

The Balkan countries, similar to the European Union countries (states) and other states of Southeastern Europe, constantly reformed their tax systems by reducing the rates, redefining the tax basis, and doing amendments and clarifications of the existing laws interpretation. Parallel to the reduction of tax rates, the reduction of tax deductions and exemptions, as counter-reimbursement for the tax rates reduction, was done. In this sense, in the following table we have presented the tax rates reformation in the selected Balkan countries and Kosova.

The main changes in personal income tax rates, corporate income tax rates and VAT in the Balkan countries from 1992 to 2009

(Table 8)

Country	Personal income tax	Corporate income tax	Value added Tax
Albania	Preliminarily 6 rates - 5% to 30% each. Since 1 July 2007 the rate is 10%,	Preliminarily it was 30% then 20% , whilst since 1 January 2008 the rate is 10%,	1996: the rate was 20% and 0%
Bulgaria	1992: 6 rates 20%, 24%, 28%, 32%, 36% and 40% 4 rates from 20% to 40% 2002: the rate from 0% to 29% since 2008 it is 10%	2000: 25% the rate, 20% for small businesses 2002: the rate 23.5% then it was 15%, whilst since 1 January 2007 it is 10%	1994: the rate 22%, 1999: reduced to 20%, exempted
Croatia	1994:00:00 2001: 3 rates 15%, 25%,35% 2003 each: additional rate 45%	1994: the rate 20%	1998: the rate 22%, 0% for books, basic foods, medicines, public utilities and financial services exempted
Macedonia	2 rates: 15% and 18% (earlier: 3 rates from 23% to 35%) 2002; rates from 0% to 38%; then there were progressive rates 15%,18% and 24%; from 1 January 2007 to 1 January 2008 it was 12%, whilst from 1 January 2008 it is 10%	Earlier 30%; then 15%; in 2007 it was reduced to 12%; in 2008 it was reduced to 10% as much as it is currently	2000: the rate 19%, reduced rate 5% for food products for humanitarian purposes, agricultural tools and mechanisms,books
Romania	2003: 5 the rate: 18%, 23%, 28%, 34% and 40%; now it is 16%	2003: the rate 25% (earlier 38%) now it is 16%	1993: the rate 22 % and 11% reduced rate; 2003: the rate 19% and 9% reduced rate, exempted financial services and public utilities
Serbia	Preliminarily 14 % a fixed rate of tax on earned income; from other income the rate of 10%, 15% and 20%; now 10%	Preliminarily the rates: 20% - 30%; 2003: 14%; now 12% for wages being reduced until 10%, whereas the income from interests, games of chance and rent maximum up to 20%	Preliminarily the sales tax with rates 20%, exempted public utilities and some food: from 2005 it is applied VAT by 3 rates: 18%, 8% and 0% for medicines, books

Montenegro	Preliminarily the fixed rate 14 % of tax on earned income; from other income the rate of 10%, 15% and 20%	Preliminarily the rates: 20% - 30% , in 2003: 14% now 10%	Preliminarily sales tax with rates 20%, exempted public utilities and some food:
Kosova	Preliminarily from 2002 : 4 rates: 0%, 5%, 10% and 20%; from 1 January 2009 four rates: 0%, 4%, 8% and 10%	Preliminarily from 2002: 20% rates for big companies and of course for small businesses; from 1 January 2009 the rate of 10%	2001: 15% and 0%, some exemptions; 2002- reduction for registration in turnover above €50,2000; from 1 January 2009 the rate 16% and 0%

Source: Mitra, P. & N.Stern, "Tax systems in Transition", WPS 2947, 2003; Kwang-Yeol Yoo, "Corporate Taxation of Foreign Direct Investment Income 1991–2001", OECD, ECO/WKP(2003) 19, Tesche, J. The Role of the State in South East Europe – Fiscal Issues, mimeo, US Treasury; VAT Rates Applied in the Member and Accession States of the European Community, DOC 2402/2003 EN, - quoted by nga Grabowski and Tomalak, op. cit. , p. 279; 2009 Index of Economic Freedom, at: <http://www.heritage.org/Index/Country/Serbia#fiscal-freedom,shkurt>, February 2009; Tax rates in the world, see : http://en.wikipedia.org/wiki/Tax_rates_around_the_world#List , February 2009; Law No. 03/L-115 on personal income in Kosova, entered into force on 1 January 2009, Law No. 03/L-113 on corporate income in Kosova, entered into force on 1 January 2009; Law No. 03/L-114 on value added tax in Kosovo, entered into force on 1 January 2009.

In the long historical context, the tax system and policy of Kosova were followed during their evolution by many changes that were made based on the changes of the political and socio-economic structure of Kosova (initially the structure on the Federal basis, then the structure by the UNMIK administration), as well as those of socio-economic relations in the production process.

Compared to other countries, the transition in Kosova started in completely different circumstances. The transition process, which in the early '90s encompassed many countries of Southeastern Europe, found Kosova initially in a situation of an undeclared war, which broke out in 1998 and ended by the Kumanovo Treaty on 10 June 1999.

On 10 June 1999, the UN Security Council approved Resolution 1244, by which UNMIK was created¹⁷ and therewith

¹⁷ See UNMIK at a Glance, (UNMIK ed., 2007) www.unmikonline.org/intro.htm

the sovereignty of the SFRY over Kosova was abolished. Until the final status settlement, Resolution 1244 vested UNMIK with legislative, judicial and executive powers¹⁸. The negotiations between UNMIK and Kosova political representatives resulted in the creation of the Provisional Institutions of Self-Government, creating so a dual system of government with divided executive and legislative power between UNMIK and the Provisional Institutions of Self-Government.¹⁹ However, UNMIK had the final power on all legal and constitutional issues. Aiming at the creation of legal system, UNMIK drafted relevant laws according to its regime of “regulations”.

Upon UNMIK installation in Kosova, the Central Fiscal Authority in cooperation with the World Bank, the European Commission and the International Monetary Fund, started the work in formulation of measures and strategy for creating an efficient tax system in the spirit of the overall economic and social development of Kosova. The creation of the tax system and policies in Kosova by UNMIK is a *sui generis* case, as it was created in practice without any internal influence and without a political dialogue of Kosovar actors.

The highest authority of the fiscal power in Kosova from 1999 to the Declaration of Independence of Kosova, on 17.02.2008, was the Special Representative of the Secretary General (SRSG) of the UN together with the Fiscal Economic Council as an advisory body to the SRSG for fiscal policy issues.

Since 1999, different taxes were continuously applied by many regulations. Substantial tax issues were reserved for the UN Special Representative of the Secretary General, whilst the issues of tax procedures were delegated to the Provisional Institutions of Self-Government of Kosova. In accordance with this, the tax forms were applied and imposed by UNMIK, whereas the levying procedures were designed by the Provisional Institutions of Self-Government, Concretely, by Regulation 2005/17, the Law on Provisional Institutions of Self-Government No. 2004/48 was

¹⁸ UNMIK Regulation 1999/1, On the Authority of the Interim Administration in Kosova.

¹⁹ UNMIK Regulation 2001/9 established the Provisional Institutions of Self-Government (PISG), which are the bodies of local government in Kosova.

approved, by which the tax procedures in Kosova were introduced.²⁰ This law also created the Kosova Tax Administration as an agency within the Ministry of Economy and Finances. Despite the creation of a relatively acceptable tax system by the Kosovars, there is yet no integrated tax code in Kosova, which would cover all the tax issues, but the tax issues are mainly arranged through the power of UNMIK regulations.

The Government of Kosova has since 1 January 2009 changed only the tax rates of main existing taxes by the Draft-law on the Amendment of UNMIK Regulation No. 2004/51 on the corporate income tax, where only the tax rate changed from 20% to 10%, by the Draft-law on the Amendment of UNMIK Regulation No. 2004/52 on personal incomes tax, the tax rate from 0%, 5, 10% and 20%, as much as they are currently, to 0%, 4%, 8% and 10%, which means that the highest rate of this tax will be 10% for taxpayers' business activities; by the Draft-law on the Amendment of UNMIK Regulation No. 2001/11 on the Value Added Tax, the tax rate was increased from 15% to 16%; by the Draft-law on the Amendment of UNMIK Regulation No. 2007/17 on excises rates in Kosova, whereby the excise on cigarettes was increased from 17 Euro per unit to x Euro per unit. These changes, made by the Government of the Republic of Kosova, aimed to create a competitive tax system for foreign investments and aimed to attract taxpayers to remove from the informal economy sector to the formal economy sector, in order for them to pay the taxes.

V. Taxation Harmonization

Although the term "tax system" makes us understand that the relations between the components constituting it have to be adjusted, practice shows that taxation in many countries is carried out by application of many tax instruments, each of which has its own objective and its own way of economic power inclusion.

²⁰ UNMIK Regulation 17/2005, On the Promulgation of the Law on Tax Administration and Procedures Adopted by the Assembly of Kosova.

The taxation systems of contemporary countries differ a great deal or insignificantly between themselves and so two similar taxation systems cannot be found. That is why one can not yet speak, for example, of a taxation system of the developed countries of the Western Europe, of the taxation system of the EU member countries, etc., however it can be spoken about separate taxation system of each country, for example of Germany, Belgium, Japan, etc.

The taxation systems of modern countries differ as far as the constituting components are concerned, in the aspect of participation of some tax forms in the structure of public revenue of fiscal character, etc.

The changes in the tax structure of contemporary countries are conditioned by a series of factors, such as: economic development, socio-economic structure (respectively if it is a matter of market oriented economy or a centralized plan economy), the way of social security funding, the level of economy openness with abroad, the character of state structure (respectively if it is a complex or unitary state), affiliation to a certain international organization, tradition and historical development, etc.

Before we see the level to which the tax harmonization of the Balkan countries with the EU member countries has arrived, we have to clarify the notion "tax harmonization". The harmonization of taxes was treated differently by different authors in the theory of taxation.²¹ Not wishing to go to the scholastics of different definitions, we think that the clearest definition is the following: "tax harmonization is a process of elimination of tax obstacles and differences of the countries included in the EU."²²

In Europe the national frontiers have remained "a narrow framework" for the development of economic activities. We are

²¹ About this see Prest, A.R., "Fiscal Policy", in ed. by P. Coffey, *Economic Policies of the Common Market*: Macmillan, London 1979, p. 76; Rounds, T.A., "Tax Harmonization and Tax Competition: Contrasting Views and Policy Issues in Three Federal Countries", 22 *Publius: The Journal of Federalism*, University of North Texas 1992, p. 91-92.

²² *International Tax Glossary* : IBDF Publications, 3rd Edition, Amsterdam 1996, p. 153.

witnesses of processes in which the economies of different countries are getting increasingly integrated through the interstate transfer of goods, capital, technology. Such a tendency is particularly pointed out in some international economic associations, especially within the European Union member countries.

Harmonization of taxes is a process that aims at avoiding the national tax measures, which may have a negative impact on the common market functioning, on the circulation of people, goods, services, capital and competition. More concretely, the 1992 Agreement on the creation of the European Community (EEC) in section 3a is emphasized “its aim for creation of a common trade policy”. The internal market of the European Community “will be characteristic for the avoidance of obstacles to the circulation of goods, people, services and capital between the member states” (EC Agreement, section 3a) and “it will be a system which ensures that the competition on the common market has not been broken”.²³ Practice has shown that the creation of the common European market with the harmonization of taxation systems would be an illusion. “The aim of the EU is to make the standardisation of national taxation systems, but to influence on them being in accordance with the objectives of the Agreement of European Community. In this context the tax legislation of the European Community may be desirable”.²⁴

Since the national tax systems are in the competence (jurisdiction) of 27 member states, it is difficult to reach complete harmonization of taxes by the EU member states. The joining of new states has deepened additionally the differences in the Union. Even after the application of the common market, there still does not exist in EU a real common tax policy. This has influenced the member states stand considering that the taxation system is still the main symbol of state sovereignty and they convey reluctantly this competence of theirs to the Union.

²³ Simon James, “Can We Harmonize Our Views on European Tax Harmonisation?”, IBDF, Amsterdam Vol. 54.2000 Nr. 6. p. 269.

²⁴ Jan De Goede, *European Integration and Taxation Law*, IBDF, Amsterdam Vol. 43.2003, No. 6, f. 204.

However, there has been achieved a great deal so far in harmonization of taxes and taxation systems of the EU member countries. The tax harmonization in application of some tax forms, such as customs and value added tax, makes possible an easier circulation of products, of capital and people. By the agreement on the establishment of the EU, legal standards have been determined on taxes, which produce legal effects to the EU member countries. According to these standards, all the member countries have the right to create their own taxation systems and apply new tax forms, but observing the obligation to harmonize some parts of it (tax rates, tax basis, etc.) by EU decisions. The EU has promulgated some special instructions (executive decisions) on harmonization of some taxes, so that a certain minimum of taxation systems harmonization has been created. Thus, there have been achievements in partial harmonization of indirect taxes, VAT and excises. A legal basis for harmonization of indirect taxes are sections 90 to 93 of the Agreement on the Establishment of the EU. By these instructions (executive decisions) tax discrimination is forbidden, which directly or indirectly would be caused by national products to the detriment of national products of other member states (countries), so harmonization of turnover tax and excises, and other turnover taxes are attempted to reach. In this sense, the aims were achieved relatively fast, so that in 1970 in member countries multiphase turnover tax, which did not offer neutrality, was replaced by the value added tax. In addition to this, there was also promulgated the Sixth Directive²⁵ as a basic document of the EU and as a legal basis for harmonization of VAT. This directive enables the application of VAT in the same transactions in all the member countries. An agreement was reached by which all the member countries should apply a standard rate of VAT - 15% and one or two lower rates that cannot be lower than 5%. In 1993, a common stand was reached on the excises application being focused with special emphasis in the turnover of tobacco,

²⁵ This directive has been changed for several times, whilst its integral cleared text was promulgated in 2006 by the denomination the EU Council's Directive 2006/112.

alcohol, energy (oil derivatives, oil, natural gas and electrical energy) products. A progress was also reached in harmonization of excise rates, excise structure (products definition, in different measures and in exemption) as well as in goods turnover, which are taxed with excises in member countries.

Thus, based on the provision of Section 25 of the Agreement on the Establishment of the European Community, the imposing of import and export customs was banned, as well as taxes with the same effect between the member countries. This applies at the same time also to finance customs. Likewise, there was achieved the agreement on cooperation and information exchange between the member countries.

On the other hand, as far as the harmonization of direct taxes is concerned, the achievements are smaller and the income and profits tax is still imposed within the framework of national countries. In the field of profits tax of joint stock companies, the EU has two objectives: (1) avoiding the harmful (prejudicial) tax competition between the member countries, and (2) enabling the free capital turnover. Until 1997, the direct tax harmonization system in the EU was not a vast action. Before then only directives of company joining as mother-daughter companies had existed, which had been, first of all, oriented to regulation (arrangement) of issues related to double taxation. After 1997, the member countries started a vast treatment directed to an action that would control the tax competition negative effects. This action was aimed at harmonization of tax provisions in three fields: in taxation of enterprises, taxation of savings income and taxation of authors reimbursement between the enterprises. Thus, the taxation package for avoiding the prejudicial tax competition, which was promulgated by the EU Council, contains:

- Code of Conduct on the occasion of enterprise taxation, by which the member countries were obliged: (1) not to apply new prejudicial tax measures, (2) to review all the tax legislation and stop all the prejudicial tax measures as soon as possible, (3) to inform each other on the measures the Code contains, and (4) to influence the interruption/cancellation of prejudicial competition in the countries outside the EU as well;

- Instruments for reducing differences in effective taxation of savings income, respectively savings interest (Eng. Savings Taxation Directive, June 2003). According to this Directive, all the member countries must ensure information exchange related to interest payments in the savings to non-residents;
- Instruments for avoiding the reducing tax of interests and royalty compensations between the companies associated in different EU member countries (Eng. Interest and Royalty Directive, June 2003). By this Directive, the EU makes the compilation of the common system of interests and authors compensation tax on purpose to avoid double taxation of these compensations. Thus, the interests and authors compensations are taxed only in the member country, where the beneficiary of these compensations has its main office (seat), and not in the country in which they were accomplished.

Another progress was made in the field of corporate profits tax, where was done the harmonization of some issues related to the tax treatment of dividend payment between the companies and their statutory changes.

Joining the EU has been from the beginning the main motive for the Balkan countries, which influenced their taxation systems reformation as well, in accordance with the above-mentioned requirements requested by the EU. Today, when from the beginning of the transition process more than 19 years have passed, within the Balkan countries teated in this analysis, Bulgaria and Romania have been the most successful in reformation and harmonization of their tax systems. These countries have managed to build transparent, righteous (they have avoided differences in tax burdens), flexible and simple tax systems. Bulgaria²⁶ and Romania joined the EU on 1 January 2007. These two countries, with their tax reforms that they did

²⁶ More thoroughly about the taxation reforms in Bulgaria, see: Konstantin Lozev, "EU Accession and the Bulgarian Taxation System", IBFD, Amsterdam, *European Taxation*, April 2007, p. 193-199.

before 1 January 2007, managed to harmonize to a quite great extent their tax systems with *acquis communautaire* (the integrity of EU laws produced so far). As far as the achievement of tax harmonization, Croatia come in the first line, and after it are placed Albania, Macedonia and Kosova. Although it has a simple legislation, Kosova has still to do a great deal in the function of fulfillment of legal gaps, tax harmonization with the EU and regulation of international tax relations aiming at eliminating double taxation. To the present day, Kosova has signed only one agreement for avoiding double taxation with Albania, and this lack of agreements for the elimination of double taxation is a serious obstacle to foreign investments in Kosova. The absence of legislation harmonization in this field will restrain the development of exchanges in these countries with the EU. These countries are still in the process of balance between the direct and indirect taxes and creation of a taxation system, which would have a neutral stand against the competition in the internal national market economy. The deadlock in this harmonization is the result of differences in levying the income and public expenses structures, economic challenges, administrative capabilities. etc. These differences make these Balkan countries to have different systems and policies from the EU ones.

The nearest prospects in these countries are in harmonization of customs tax policies. Such a thing would be achieved by gradual reduction of customs duties (taxes) until their complete removal, the way the European Union did.

I think that great efforts are to be made in the future for harmonization of tax systems of these countries with the EU..

VI. Conclusions and Recommendations

Each Balkan country has gone, from the start of the transition process in the 90s to the present day, in the process of tax reforms, through a special path differently in different countries, bearing on itself certain features.

However, the trends of reforms and objectives for joining the EU were and remain common. In this context, all the Balkan

countries applied in different years their taxation systems, VAT, the corporate income tax, personal income tax.

In the process of taxation systems reformation, there are two trends, in addition to others, to be distinguished: a) The trend of reducing tax rates of the main taxes, with special emphasis on corporate income tax, and b) The aspiration and actions of all the Balkan countries for joining the EU by adopting the EU rules. Some of the selected countries in this analysis have managed to even become members of the EU, such as Bulgaria and Romania. Others have still a road to make.

The tax system and policies, built by UNMIK, had only fiscal purposes. UNMIK created this policy: a) not in accordance with the specificities of the economic development of Kosova, b) in the absence of a strategy of the economic development of Kosova, c) in the absence of the political status settlement, and d) in the absence of real recognition of the main macroeconomic indicators, whose recognition is a *conditio sine qua non* for a sustainable fiscal policy. Based on such a situation, the tax system and policies had only fiscal functions with a very high participation of indirect border taxes in the total tax income.

Therefore, surpass these challenges, we think that the following measures are to be applied:

Firstly, there ought to be established a statistical office of Kosova, which would determine the macroeconomic indicators and other relevant indicators on the real basis as indispensable conditions for conducting real economic reforms.

Secondly, there ought to be created a long-term development strategy of Kosova and, in accordance with it, a long-term and sustainable fiscal policy ought to be formulated.

Thirdly, an internal taxation system ought to be created, so that from direct taxes and internal VAT larger income could be collected, so that the tax burden could be transferred from the border to the inner land. This is due to the fact that the state, which builds its taxation system only on indirect taxes, burdens the export of its products, as their competitive capability will be poorer in the external market in relation to the products of a country in which a balance between the direct and indirect taxes exists.

In the case of export, its production price is lower, as it is burdened with the turnover tax as an integral part of the price of the products.

The achievement of the balance between direct and indirect taxes would enable for the tax system of Kosova to have a neutral effect against the competition and at the same time the request for financial funds and for financing the social needs would be accomplished. Parallel to this, there ought to be reduction to maximum or complete removal of the fiscal burden (customs, excises and VAT) on the imported goods in Kosova, which serve as a raw material for the resident and foreign investors. Tax facilities to stimulate foreign and internal investments would urge the economic development, which is an essential condition for a later growth of fiscal capacities of the taxation system of Kosova..

Fourthly, there ought to be established unified, modern, professional and efficient tax administration services, which are essential conditions for a successful application of the taxation system and policies in Kosova. The taxation system can be efficient only if a successful implementation of the tax rules and legal enactments by the tax administration, as well as the identification of taxpayers, are ensured. In the context of the accomplishment of these objectives, the Ministry of Economy and Finances ought to accelerate its efforts for perfection, respectively for the perfection of tax administration in accordance with the recommendations of the International Monetary Fund.

Fifthly, it has to be formed a task force of experts on the highest level, for the purpose of initial codification of the positive tax law and harmonization and adoption of EU laws with Kosova, as much as the specificities of the economic development of Kosova allow such a thing.

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