

## Fiscal Amnesty and its role in the formalization of the Albanian economy

Prof. Asoc. Dr. HYSEN MUCEKU  
European University of Tirana  
Albania

### Abstract:

*The informal economy is considered by many researchers as a great shock to the competition in the market that slows down a country's economic development.*

*A major reason that affects the development of the informal economy of a country is the failure of government policies and strategies on economic growth, reducing unemployment and effective allocation of public resources. Many economy experts and politicians, incapable of eliminating it, debate for finding methods to reduce it as much as possible and keep it within acceptable levels.*

*Different researchers consider that fiscal amnesty is an important mechanism that stimulates economic development through the release of capital and cash that recycles in the economic turnover and reduce the informal economy.*

*Different analysis argues that the fiscal amnesty has its effects both positive and negative. If the main objective of the fiscal amnesty has not fulfilled the expected levels, this policy can create the belief and stimulate other expectations of amnesty in the future, compromising the regular payments of fiscal duties after the amnesty.*

*In this paper are discussed the problems and are provided arguments in respect of the implementation of fiscal amnesty in Albania, its necessity for economic development, the practical implementation of this policy and its impact on the formalization of the economy and increase revenue to the state budget.*

*Experiences of practical implementation of the fiscal amnesty show that its application relates to the more practical objective required to be achieved than with the situation of a country's economic development or professional level and professional competence of bodies tax collection. Therefore, different countries with different stages of political development have followed this policy with the main goal to formalize the economy and increase revenue to the state budget.*

**Key words:** informal economy, fiscal amnesty, capital, money, economic recycling

## **INFORMALITY IN THE FISCAL AREA AND THE ROLE OF FISCAL AMNESTY IN THE FORMALIZATION OF THE ECONOMY**

The main revenues in the state budget are provided by the fiscal system, so this is the main system for financing public expenditures. In an effective tax system taxpayers meet themselves (through self-assessment and payment) tax obligations without the intervention of the fiscal administration. But the administration of the fiscal system is a matter of concern for developing countries as well as developed countries, because without the intervention of the fiscal authorities do not fully met fiscal obligations.

In the informal economy many factors have their own impact, each of which has a specific weight, but a huge impact on the growth of the informal economy have tax evasion and tax avoidance. The main characteristic of informality in the field of fiscal evasion carried out by entities violating the law deliberately non-payment or reduction of tax liability and tax evasion by using the shortcomings of fiscal legislation.

For many experts in the field of economy an important factor that encourages informality is the perceived lack of justice in the tax system by taxpayers and high fiscal burdens. Many taxpayers who commit tax evasion or tax avoidance consider fiscal system not fair in three main areas: (1) in the

tax burden they carry, (2) in their treatment from the tax system compared with other taxpayers, and (3) benefits that from the public goods and services that are offered. Most taxpayers who conduct informal activities consider the tax burden high and unable to deal with compared to the amount of income, determine different treatments (tax assessment, tax control and sanctions in comparison with other taxpayers), and also do not see the benefits right from the distribution system (delivery) of public goods.

The biggest challenge to the informal economy is to find ways and means to integrate it into the formal economy. Economic policy of a country should establish appropriate mechanisms that promote the getaway from this economy, supporting individuals and entities that are part of this sector through financing and various amenities.

In Albania, during recent decades the frequent changes in taxation, the lack of effective communication with stakeholders, the increasing arbitrary actions of the tax authorities, have worsened the business climate leading to mismanagement of tax collection and increased efforts to reduce tax liability.

Tax evasion is reflected in speculations with the values of assets on the balance sheet, in informal employment, unrealistic wages of employees in social and other outstanding obligations.

In the case of Albania, where the level of the informal economy has been quite high for several decades, has become necessary to undertake fiscal amnesties by state authorities which presuppose forgiveness of fiscal arrears towards state, charges which have been unable to be paid by taxpaying entities. Through amnesty the state is requiring to provide an opportunity for both individuals and businesses to pay arrears and legalize previously undeclared assets.

Albania's main sources of income and capital from the fiscal amnesty would be:

(1) The income of immigrants, which for various reasons were not declared or may be held abroad in order to avoid tax liabilities of the country of origin. The phenomenon of "migration" of capital is usually due to a relatively high level of taxation in the country of origin. Income immigrants make up a significant part of revenue at a time when fiscal amnesty applies. Therefore, it was thought that the tax amnesty is the appropriate tool to attract these funds and include them in the economic turnover; and

(2) The withdrawal of capital from parts of the undeclared economy is described as "gray economy". A considering part of businesses operating in the country with two statements hid a significant portion of their assets. But it should be noted that the "gray" economy does not refer to "black" economy. Part of the "gray" economy includes work and money earned by honest work, but for various reasons (such as tax burden, property, state, etc.), it is not formalized. By accepting this reality, the appropriate ways should have been defined to solve the problem efficiently for the benefit of all parties involved.

Enterprise of fiscal amnesty was necessary because:

Firstly, for various reasons, the taxpayer did not declare and pay duties and with the remission of penalties, not declaring tax payers of state begin by registering and paying obligations to the state budget.

Secondly, a number of taxpayers are penalized for failing to keep records according to legislation statements for irregular and incomplete accounts, balance sheets, the basic documentation of tax and accounting, non-delivery on time of the documentation to the tax authorities etc. Through fiscal amnesty they would begin to keep according to law records and, accounting and tax documentation.

Thirdly through amnesty to the taxpayers is given the opportunity to review and correct their tax statements without paying penalties.

Finally, through amnesty, to the taxpayers is promised non-investigation for the source of income, as well as non-prosecution for all violations detected.

## **THE PURPOSE AND OBJECTIVES OF THE STUDY**

The main goal of the study is related to the determining of the necessity of fiscal amnesty on the formalization of the economy, its benefits and its negative impacts.

The most important objectives of the study related to the main reasons why we should apply the tax amnesty are:

Firstly, fiscal amnesty is expected increase the revenue in the domestic economy as a result of asset growth and declared capital by businesses, so as a result we will face the formalization of the economy. So, an important objective is measuring the impact on public revenues.

Secondly, fiscal amnesty is expected to lead to the increasing of taxpayers base, because many of them will be encouraged to take advantage of such an opportunity to legalize their source of income earned. So, another objective is to measure the impact of the amnesty on tax base growth.

Thirdly, the application of the fiscal amnesty is related to the financial crisis that many countries and corporations are facing as a result the reduction of the amount of liquidity. Through the implementation of the fiscal amnesty the “sleeping” capital of individuals and businesses will be used in the formal economy.

## **RESEARCH QUESTION, HYPOTHESIS AND METHODOLOGY PAPER**

- *The basic research question is:* Does the tax amnesty have impact in formalizing the economy - the case of Albania?
- *The hypothesis of the paper:* Fiscal amnesty affects in the formalization of the informal economy if its implementation has

a full legal basis, taxpayers are aware of its benefits and tax administration is efficient in its implementation.

• *Methodology of the paper.* To conduct the study used comparative analysis, interpretive and analytical analysis.

## **ANALYSIS AND THE INTERPRETATION OF RESULTS**

Before taking a decision on fiscal amnesty, the decision-making authority makes an assessment of the fiscal situation, analyzing the deficiencies of the existing fiscal system, the degree of cooperation of the taxpayers to pay taxes voluntarily, the quality of fiscal administration activities and the expected changes. So, the during decision-making process from the Government, firstly are determined the problems of the fiscal system by analyzing its current situation, because if these problems are not detected exactly where they are, amnesty can bring more negative effects than positive ones. Decisions on the right to participate have significant effects on the assessment of income that tax amnesty seeks to achieve.

In making the decision to implement the fiscal amnesty, particularly these factors should be analyzed:

(1) The right to participate (benefit). It must be determined which individuals and taxpayers have the right to benefit from a fiscal amnesty. But it should be noted that from the standard practices applied in many countries anyone who had tax arrears, undeclared actives, or adjustments of their amounts has been allowed to be part of fiscal amnesty, as long as their solvency for these unpaid taxes is not known for fiscal administration. Declaration of assets may prompt the taxpayer interest, seeing that he has not been validated by the fiscal administration. As for taxpayers with debts that were recorded during time by the fiscal administration, implementation practices have proved that the amnesty has been allowed for certain types of infringement, while for others not.

(2) Fiscal amnesty should specify which taxes would be amnestied. Some amnesty directed to a particular group of taxes such as income tax, personal income tax, wealth tax etc. This is accomplished depending on the characteristics of the fiscal system of the country where it is implemented. Some countries in recent years in the announcement amnesties have tended to further attract the capital of individuals who have illegally transferred it to other countries. Through these amnesties the income tax liabilities of previous periods that were not reported to the tax authorities are reduced or removed.

(3) Fiscal amnesty should determine ahead of its announcement: which will be the sum of amnesty (forgiven)? which is the concept (meaning) of the unpaid tax? and which will be subject to interest and penalties from the tax amnesty forgiveness.

(4) Should be determined the duration of the fiscal amnesty. An amnesty can be declared as an opportunity only once or for a specified period of time.

The decision to undertake fiscal amnesty is complex and difficult, which can be taken only after an extensive analysis of positive and negative impacts that may have the application of amnesty in the future. But it is important to highlight the benefits and disadvantages of it. The main benefits of a fiscal amnesty are:

1. Through fiscal amnesty capitals and legal property of taxpayers increases and thereby increases borrowing capacity and their financial impact on the economic development of the country. In particular, in times of crisis, the fiscal amnesty will stimulate business by increasing its lending activity, which in times of crisis suffers significant decline.
2. The implementation of fiscal amnesty leads to increased voluntary payment of taxes and the establishment and implementation of a more rigorous fiscal discipline

during the post implementation period. Amnesty defenders argue that voluntary payment of fiscal duties, after the implementation of the fiscal amnesty may increase, as the number of people who want to follow the rules grows. Business opportunity posed by established the amnesty makes them not hide their activity, making them to increase the tax base in future periods. A successful amnesty is accompanied by comprehensive reforms aiming legal applicability and implementation of fiscal rules.

3. Amnesty serves as stimulant to introduce the country's new capital investments through the repatriation of funds from abroad. This is a long-term economic benefit, allowing the entry of new additional liquidity within the financial system.
4. The amnesty affects the increase of legal collateral to the banking system. So, banks will lend more to the economy, the private sector, families and businesses.
5. Through the elimination of sanctions and burden businesses release the accumulated stress due to frequent administration pressures facing fiscal and sanctions.
6. Fiscal amnesty serves as a source of short-term generation of the income budget. Through fiscal amnesties governments especially seek income growth not only in the short period, but in the long term one as well.
7. Another benefit of the amnesty is that it makes fiscal authorities to reduce red tape and administrative burdens leading to the reduction of administrative costs of collecting the revenue.
8. Recognition and insurance of legal property rights. Through fiscal amnesty to the taxpayers is offered a good opportunity not only to formally declaring their income, but also the investment of these revenues since

fiscal amnesty gives them the possibility of recognizing and guaranteeing the right formal ownership of these revenues and wealth.

Some of the main deficiencies found by the practical implementation of the fiscal amnesty are:

1. Fiscal amnesty can be used as a tool for laundering money obtained from illegal sources, thus it constitutes an added risk. Opponents of the fiscal amnesty implementation use the argument that amnesty can create negative impact (especially psychological) on ordinary taxpayers, who would be "disappointed" by treating them in the same way as taxpayers who have violated the law until then. Precisely this is the strongest argument of opponents of the fiscal amnesty. So, amnesty can be interpreted as a form of discrimination to taxpayers who have regularly paid taxes, affecting a "step back" in the future of regular taxpayers to implementing fiscal obligations, resulting in reduction of revenue to the state budget.
2. Through the implementation of such a policy the targeted taxpayers can create the idea that this kind of "forgiveness" will happen again in the future. In this way, the amnesty will encourage this targeted group to repeat the tax evasion again in the future by claiming that the tax administration will be forced to make other fiscal amnesties. So, it would prompt the next non-repayment of obligations after the implementation of the fiscal amnesty.
3. Fiscal amnesty "reduces" a significant part of its "alleged income" in the state budget. If according to fiscal registries, the income recorded as a result of non-payment of taxes would have been collected and poured into the state budget, increasing significantly public

revenues by creating opportunities for the development of social policy by government.

The question is, who are the beneficiaries and what are the benefits from the fiscal amnesty? The first beneficiary is the state, which through amnesty draws towards formal economy important parts of capital and income, which during the previous situation these were not active and couldn't serve as financial assets.

Important beneficiaries are taxpayers, where fiscal amnesty encourages the development of their activities in a legal way. So, through the forgiveness of fiscal obligations is thought that taxpayers in the future will carry out activities with transparency and in accordance with the law, making them more reliable for lenders and while stimulating lending business this will create more opportunities for capital growth. Also, the amnesty of "releasing" the taxpayer from the stress created in previous periods due to the arbitrary actions of the fiscal administration.

Fiscal amnesty has a positive impact on financial markets, especially banking. Through this, it is expected that a significant proportion of capitals circulating in cash (outside the banking system), as well as in the form of real estate putting them into circulation THROUGH banking system.

Also, fiscal amnesty encourages formal economy affecting the growth of social welfare in the society, because by recycling capital in the economy is expected to increase the number of jobs and GDP.

From the experience of countries that have implemented fiscal amnesty turns out that the implementation of the fiscal policy has led to improved fiscal behavior by encouraging voluntary disclosure of taxpayers, as well as has improved fiscal management by the tax authorities.

If this policy is not applied properly or supported by a comprehensive legal framework, it may have negative effects,

such as the thought that the governmental institutions are being unfair to them, equaling the subjects who have been correctly paying fiscal obligations with entities that were not correct to these obligations.

### ***Implementation of the fiscal amnesty in Albania and its effects on the economy***

In recent decades, the Albanian economy on the path towards consolidation of the market economy has initiated important reforms particularly in the fiscal system. In different periods has been initiated mitigation and forgiveness to ease fiscal tax burden and putting into economic circulation the undeclared money and capital.

During 1993 – 1996, the system created some incentives and tax exemptions in order to stimulate productive activity, such as: exemption from income tax for the first 4 years of production activities, deduction from income tax when the profit reinvested in Albania by foreign investors, and allowing the creation of provisions for losses and risks, etc., These measures helped thousands of manufacturing businesses that began to emerge in this period, being exempted from income tax for the first four years of operation, therefore creating the opportunity for investment in technology and infrastructure. Besides the positive effects that these measures had in the country's economic development, ensuring macroeconomic stability and strengthening free enterprise, some of these incentives began to turn more and more into an effective tool for avoidance of tax liabilities and tax evasion. Thus, many companies created in the years 1992 – 1996, after benefited from tax relief for the first four years of operation, began recycling by creating new legal entities in order to benefit for four other years of tax facilities, so this formula can not operate indefinitely and thus it became indispensable the change of laws and fiscal management procedures in subsequent years.

During January 2011 – March 2012, amnesty was undertaken to promote the formalization of the Albanian economy, to close the roads of “dirty” money and organized crime in the country's economy. The aim was to improve the business climate in the country by establishing strict co-operation relations between taxpayers, citizens and administration bodies. Thus, law nr.10418, dated 21.04.2011 "On the legalization of capital and forgiveness of a portion of the tax and customs debt" defined the beneficiaries of this amnesty, which would be:

- Individuals who will voluntarily declare the undeclared and non legalized monetary amount and the first authentication will pay only 3% of the value. All taxes and unpaid insurance by the end of 2010 were pardoned to these individuals.
- Social and health insurance and fines due to unpaid interest on arrears of 31 December 2008 were pardoned to the self-employed ones and the last 2 years if they paid their liability insurance for 2011.
- To individuals and small business, will be forgiven the penalties and late payment fees for their employees, until 31 December 2010.
- To taxpayers customs tax debt was forgiven which consisted of fines and late payment interests until December 31, 2008.
- The taxpayers who paid 50% of the principal of the customs debt for 2009 were pardoned for the obligations related to this debt, while for 2010 if they paid 100% of the principal of the customs debt penalties and delay interest were forgiven.
- Taxpayers were pardoned for interest on arrears and penalties for social security and health obligations outstanding.
- All Albanian companies that had on their balance sheets real estate and machinery valued below market value,

they could make their reassessment by reflecting it the balance sheet of 2011.

For the implementation of the fiscal amnesty it is important to define clearly the beneficiaries, which liabilities will be pardoned and when will amnesty be applied.

Because of the rush in which the law was proposed and consented in parliament, without consultation with stakeholders, the method of implementation and the lack of study of the effects on the economy, the state budget and the perception of taxpayers, it highlighted a series of problems.

According to the predictions of economists from this amnesty was expected to be legalized about 3.5 billion Euro, which by this time were not stated, but its result was the legalization of only about 25-30 million Euro. A significant portion of the amount expected to be legalized and introduced to the Albanian economy was transferred abroad. So, the implementation of the amnesty failed to achieve the purpose for which it was taken, for a variety of reasons:

Firstly, the legislation that was passed was not complete, since the Constitution of Albania provides for the adoption of the amnesty law by qualified majority vote (3/5 of deputies), instead this law was passed only by a simple parliamentary majority, so therefore the legal requirement was fulfilled for this amnesty to have the right impact. Failure to meet this condition brings failure, because taxpayers who could declare hidden income don't have enough guarantees that in the future (with the change of parliamentary majority) they will not be subject to administrative and / or criminal sanctions.

Secondly, this amnesty failed to achieve its goal due to "moral damage" ("moral hazard"), its impact to the taxpayers who pay their dues regularly. During 2008 – 20120 in Albania were undertaken three legal initiatives that had fiscal amnesty elements, namely: in 2008 the law was passed to forgive a portion of the taxes and customs duties as well as unpaid social

and health insurance; in 2010 the law was passed to allow the addition of capital of the companies through previously undeclared income of individuals; and during April 2011 – March 2012 was adopted the law "On fiscal amnesty". So, in a short time period were executed a few amnesties causing the taxpayer to establish idea for other amnesties, and in this way amnesty had not taken proper effects.

Thirdly, fiscal administration capabilities for a legal administration of this process were limited. Undertaking such an initiative brought some questions: (1) why would it be necessary this "amnesty" in these conditions and circumstances? (2) why would it be extended as in time as in the type of liability?, and if fiscal administration would have the appropriate management capacities, these capacities could have been used to collect unpaid debts. But the practical application of this amnesty resulted that the fiscal administration not only had a limited capacity, but in many cases were found to slow actions and contrary to the law

Also, it should be noted that this was a complex legal initiative that firstly had to be consulted with stakeholders and accompanied by awareness campaign and publicity, in order to make it clear for the taxpayers about the benefits this forgiveness. But this amnesty did not consult with stakeholders and was not associated with sensitization and publicity campaign, and therefore its impact was quite limited.

## **CONCLUSIONS**

For the amnesty to be successful, taxpayers have to believe that it happens only once and amnesties are not part of fiscal policy, so, taxpayers will not have additional opportunities to benefit from it. Also, fiscal institutions should note the subjects that benefit from amnesty, that their money and undeclared capital to be declared shall remain their property registered in the formal sector of the economy.

Fiscal authorities must maintain confidentiality to statements related to subjects. Amnesty should educate the people with a sense of fairness by considering not paying taxes a mistake that should not be repeated in the future.

Fiscal amnesties made in Albania failed expectations for a series of problems, such as the rush in which the law was proposed and consented in parliament, without consultation with stakeholders, the method of implementation and the lack of study of the effects on the economy, the state budget and the perception of taxpayers.

Economy analysts recommend that tax amnesties should not be common policies of the government, as they discourage regular taxpayers and encourage tax evaders hiding and withholding obligations in anticipation of the next amnesty. So fiscal amnesty should not be seen as the most simple and fast solution whenever the government has the needs for liquidity.

Before implementing the amnesty it is important to make a preliminary assessment of the situation by identifying shortcomings of the existing fiscal system and, the tax administration responsible for its implementation should be well trained. Informing taxpayers through an awareness campaign is an important step in highlighting its benefits for all stakeholders. Also, the predictions should be made for the purpose of calculating benefits and expectations of its impact on the economy, the state budget and taxpayers psychology.

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