



## Research Article

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### Harmonization of Value Added Tax in Albania and Countries of the Region: Challenges and Perspectives in the Context of European Integration

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#### Abstract

Value Added Tax (VAT) is one of the main sources of budget revenue for most countries, including Albania and the countries of the region. As an indirect tax on consumption, VAT provides stable revenues for the state and directly affects the economic structure and market competitiveness. The approximation of VAT policies with international standards, in particular with the EU VAT Directive (2006/112/EC), is a key step in the European integration process for the Western Balkan countries.

In Albania, VAT was first implemented in 1996 and has undergone several reforms to increase efficiency and combat tax evasion. In addition to Albania, countries in the region (Kosovo, North Macedonia, Montenegro and Serbia) have similar VAT structures, but with differences in tax rates, exemptions and fiscal administration. In this sense, the paper aims to analyze the VAT system in Albania and compare it with countries in the region, identifying similarities, differences and key challenges. In this context, the study will address questions such as:

- How does VAT legislation differ between Albania and countries in the region?
- What are the factors that influence the collection of VAT revenues?
- How harmonized is the VAT of these countries with EU standards?
- What reforms could be undertaken to improve the VAT system?

Regional comparison is important, as the Western Balkan countries have similar economic structures and face common challenges, such as high informality and tax evasion. Furthermore, while some countries such as Serbia and Montenegro have advanced in EU accession negotiations, Albania and North Macedonia are still in the initial stages of this process. Analysing different experiences in the region can help identify best practices for a more efficient and transparent tax system.

To address this topic comprehensively, the study will be based on a combined methodology, including:

- Legal analysis, to compare VAT legislation in countries in the region;

- Statistical data to assess the contribution of VAT to budget revenues;
- Comparative studies, to understand changes in VAT rates and administration;
- Institutional reports, from international organizations such as the IMF, OECD and the European Commission.

**Keywords:** Value Added Tax, Albania, Region, Harmonization, Challenges and Perspectives, European Integration.

## 1. Introduction

Value Added Tax (VAT) in Albania is regulated by Law No. 92/2014 “On Value Added Tax in the Republic of Albania”, which entered into force on 1 January 2015 and has undergone several changes to adapt to EU standards.<sup>1</sup> This law replaced the previous VAT law, aiming to improve tax administration and increase transparency. The standard VAT rate in Albania is 20%, while for some special categories a reduced rate of 6% is applied for services such as tourism and books. VAT exemptions include sectors such as education, healthcare, and some financial activities. VAT administration is carried out by the General Directorate of Taxation (GDT), which has implemented new digital systems to reduce tax evasion, such as electronic fiscalization that has been implemented since 2021 (General Directorate of Taxation, 2023).

In the Western Balkans region, countries have similar VAT structures, but with some differences in tax rates and fiscal exemptions:

Kosovo applies a standard VAT rate of 18%, while there is a reduced rate of 8% for basic products such as food and books (Tax Administration of Kosovo, 2022). North Macedonia applies a standard rate of 18%, while a reduced rate of 5% applies to some food and pharmaceutical products (Ministry of Finance of North Macedonia, 2023). Montenegro has a VAT rate of 21%, which is higher than other countries in the region, but with reduced rates of 7% and 0% for certain categories (OECD, 2023). Serbia on the other hand applies a standard rate of 20%, with a reduced rate of 10% for some goods and services (Tax Administration of Serbia, 2022). These changes in tax rates significantly affect trade competition between countries in the region and the decision-making of businesses to operate in one country or another.

The EU has a harmonised VAT system, set out in Directive 2006/112/EC, which lays down principles for the application of VAT in the member states.<sup>2</sup> Albania and other Western Balkan countries are in the process of approximating their legislation to this directive. Some of the aspects where there are still differences between VAT in Albania and EU requirements include:

- Taxation of cross-border supplies: The EU has a clear regime for cross-border supplies of goods and services, while Albania still has challenges in administering VAT for international transactions (European Commission, 2023);
- Tax exemptions: Some categories that are taxable in the EU, such as financial

<sup>1</sup> Law No. 92/2014, “On Value Added Tax in the Republic of Albania”, as amended, Official Gazette of the Republic of Albania.

<sup>2</sup> EU Council Directive 2006/112/EC, on the common system of VAT.

services, continue to be exempt from VAT in Albania (IMF, 2022);

- VAT administration and collection: While EU countries mainly use advanced digital systems for VAT declaration and payment, Albania and some countries in the region still have problems with tax evasion and high informality (World Bank, 2023);

In order to align with the EU, Albania has taken several measures, such as the fiscalization system and strengthening tax controls, but there is still a need for improvements in the transparency and efficiency of the tax system.

## 2. Comparative analysis of VAT in the region

Value Added Tax (VAT) in Albania and the countries of the region have important similarities and differences in terms of tax rates and fiscal exemptions. The main differences between these tax systems include:

- Tax rates: Montenegro has the highest standard rate (21%), while Albania, Kosovo and North Macedonia apply rates between 18-20%;
- Reduced rates: Albania has a reduced rate of 6%, while other countries apply different rates for specific categories such as food products, books, and tourist services;
- Fiscal exemptions: All countries in the region exempt sectors such as education and health from VAT, but the differences lie in financial services, which in some countries are partially exempt;

The efficiency of VAT collection is related to the administrative capacity of tax institutions and the level of informality in the economy. According to the OECD Tax Administration Report (2023), Albania has significantly improved VAT administration through fiscalization reform, but still faces challenges in effectively collecting tax revenues. In this sense, Albania has implemented electronic fiscalization from 2021 to reduce tax evasion (General Directorate of Taxation, 2023). Montenegro and Serbia have also adopted advanced digital systems (IMF, 2022). Kosovo and North Macedonia still face challenges in this regard. In Albania, tax evasion remains a serious problem, especially in the construction and trade sectors (World Bank, 2023). Montenegro and Kosovo have similar levels of informality (30-40% of GDP) (Doing Business Report, 2023). According to the Doing Business Report (2023), Albanian businesses spend an average of 252 hours per year to comply with tax obligations, more than the regional average. Serbia and North Macedonia have easier and faster processes for VAT declaration.

### 2.1 Performance of VAT revenue collection compared to GDP

VAT revenues are a key indicator of the efficiency of the tax system. The table below presents VAT revenues as a percentage of Gross Domestic Product (GDP) for countries in the region. Montenegro and Serbia have the highest percentage of VAT revenues compared to GDP, thanks to higher rates and more effective administration.

Albania has made improvements, but lags behind the region due to tax evasion and informality. North Macedonia has the most balanced system, managing to collect over 10% of GDP through a relatively low tax rate. This section provided a detailed comparison of tax rates, administration and VAT collection in Albania and countries in the region. The data show that Albania has made improvements, but lags behind countries such as Montenegro and Serbia in VAT collection efficiency. The main challenge remains tax evasion and high informality, which require further reforms to improve the tax system.

### **3. Challenges and opportunities for improving the VAT system in Albania**

VAT administration in Albania faces a number of challenges that affect the efficiency of tax revenue collection and harmonisation with European Union standards. One of the biggest challenges of the tax system in Albania is tax evasion, which is estimated to be between 30-40% of GDP (World Bank, 2023). Many businesses operate informally, avoiding tax obligations and creating unfair competition for entities that pay VAT. Main reasons for tax evasion include lack of effective monitoring by tax authorities, fictitious declarations and manipulation of invoices to reduce tax liabilities, payments outside the banking system, which make it more difficult to track transactions.

Although Law No. 92/2014 on VAT has brought some improvements, the legislation remains complex and cumbersome for businesses, especially small enterprises. Frequent changes in the VAT law and the lack of legal clarity often create uncertainty for taxpayers (General Directorate of Taxation, 2023). The General Directorate of Taxation (GDT) has made efforts to modernize the VAT collection system, but still faces limited human and technological resources, which affect the effective supervision of taxpayers, complicated bureaucratic processes, which delay VAT reimbursement for businesses, uneven application of rules, which create space for corruption and abuse (OECD, 2023). The electronic fiscalization system, implemented since 2021, has brought increased control over transactions and a reduction in tax evasion. However, for more effective implementation, improvements are needed in real-time monitoring of electronic invoices to identify anomalies and tax evasion, strengthening sanctions for entities that avoid fiscalization, including fines and blocking of activity and in facilitating procedures for small businesses, to avoid administrative burden (Ministry of Finance of Albania, 2023). VAT refund is an important process for exporting businesses and investors, but in Albania it is often delayed due to complicated procedures. Some measures for improvement could be to establish a clear legal deadline for reimbursements, avoiding unjustified delays, to automate the process of verifying reimbursement requests, to reduce human intervention and the possibility of corruption (IMF, 2022).

Several countries in the region have adopted more favorable fiscal policies for sectors that directly impact economic development. Albania aims to join the EU and one of the main requirements is the harmonization of the VAT system with the EU Directive 2006/112/EC. To this end, some necessary measures are gradual elimination

of excessive tax exemptions, which are not in line with EU rules, improving information exchange with tax authorities of EU countries, to avoid cross-border VAT fraud,<sup>3</sup> implementing a unified VAT reporting mechanism, facilitating international transactions for Albanian businesses. This section analysed the main challenges in VAT administration in Albania and proposed measures to improve the system. Through further digitalization, improved refunds, and harmonization with the EU, Albania can increase the efficiency of VAT collection and reduce informality in the economy.

#### **4. Perspectives and possible reforms for the VAT system in Albania**

In recent years, Albania has made significant strides in modernizing its (VAT) system, but remaining challenges require further reforms to improve revenue collection and reduce the level of tax evasion. As Albania aims for EU membership, alignment with Directive 2006/112/EC on VAT is a must. This includes:

- Reducing exemptions and differentiated rates, to bring about a more unified and predictable system for businesses
- Implementation of a common VAT reporting system, which would facilitate cross-border transactions;
- Cooperation with EU tax authorities to stop cross-border VAT fraud

The electronic fiscalization system has brought several benefits in monitoring transactions, but to achieve maximum efficiency, it is necessary to:

- Expand the use of artificial intelligence and data analysis to more quickly identify fiscal abuses;
- Develop an automated VAT refund system that would reduce delays and bureaucratic interference;
- Increase awareness among businesses about the advantages of fiscalization, to increase inclusion in the system (OECD, 2023).

One of the main challenges of the tax system is the lack of trust on the part of taxpayers. For this reason, it is recommended:

- Strengthening the fight against corruption in the tax administration, through increased control and complete digitalization of processes;
- Increasing communication between taxpayers and tax authorities, through consultative mechanisms and interactive platforms;
- Developing fiscal education campaigns to raise awareness about the obligations and benefits of a fair tax system (IMF, 2022);

To address the identified challenges and increase the efficiency of VAT collection, Albania could undertake a series of reforms that would help formalize the economy and increase budget revenues. A simpler and clearer VAT system would help businesses and reduce the scope for abuse. Some important steps include:

- Unifying VAT rates, reducing exemptions and reducing opportunities for tax evasion;

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<sup>3</sup> EU Council Directive 2006/112/EC on VAT.

- Improving VAT declaration and payment procedures, through simpler and more intuitive electronic platforms;
- Creating a “flat tax” for certain categories of businesses, reducing the complexity of the tax system;

To promote inclusion in the tax system, the government can create mechanisms that incentivize businesses and citizens to comply with fiscal rules. These could include:

- Tax relief for businesses that declare regularly and without delay;
- Tax credit systems for consumers who request regular invoices, as is the practice implemented in other countries in the region;
- Development of a “fiscal credibility program”, where businesses that meet certain criteria can benefit from administrative relief;

Given that Albania is part of regional initiatives such as Open Balkans, better coordination with neighbouring countries could help improve VAT collection. Some steps include:

- Exchange of information between tax administrations in the region to prevent cross-border fraud;
- Harmonizing VAT rates with neighbouring countries, to avoid trade diversion due to fiscal differences;
- Developing joint mechanisms to combat tax evasion, benefiting from the successful practices of other countries;

In general, to improve the VAT system in Albania and bring it into line with EU standards and regional best practices, several key measures are recommended:

- Harmonization with EU directives, to increase transparency and ensure a sustainable tax system;
- Complete digitalization of VAT administration, to minimize evasion and simplify procedures for businesses;
- Strengthening measures against tax evasion, through harsher penalties and better control mechanisms;
- Creating incentives for honest taxpayers to encourage voluntary participation in the fiscal system;
- Regional and international cooperation to prevent fraud and improve VAT administration at the cross-border level

## 5. Conclusions

The analysis of the Value Added Tax (VAT) system in Albania and in the countries of the region shows that this type of tax is one of the main sources of budget revenues, but its administration faces significant challenges. The comparison with the countries of the region, such as Kosovo, North Macedonia, Montenegro and Serbia, highlighted differences in VAT application rates, fiscal exemptions and efficiency of revenue collection.

Albania has made progress in modernizing the tax system through electronic fiscalization, but tax evasion and informality remain key challenges that hinder a

more efficient VAT administration. The complexity of tax legislation and cumbersome bureaucratic procedures also create uncertainty for taxpayers and slow down VAT refunds for businesses.

In this context, to improve the performance of the VAT system, several measures are recommended:

- Improving the supervision and monitoring of transactions through the full digitalization of the tax process;
- Simplifying procedures for businesses, especially small and medium-sized enterprises, by reducing the administrative burden;
- Harmonization with European Union standards, to facilitate Albania's integration into the European common market;
- Strengthening tax administration and strengthening mechanisms against tax evasion, to increase taxpayer confidence and ensure more revenue for the state budget.

If these measures are implemented effectively, Albania can increase the efficiency of the VAT system and improve the business climate, ensuring a more transparent and sustainable tax system.

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