Reforming the Management of Income in the Albanian Tax Legislation

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Abstract

The reform of the Albanian tax system is a process that began almost three decades ago and continues even today. During this period, this process has been complex and quite difficult since the issues related to taxes, especially those concerning income, have been very delicate and sensitive for Albanian citizens. This paper aims to identify some of the most important problems in the field of income taxation, mainly with the application of new legal changes related to the taxation of income from freelancers and small businesses. For the realisation of this study, a combination of qualitative and quantitative methods was used simultaneously. Statistical analyses, surveys, interviews, and specific case studies have been taken as the basis for formulating the conclusions and specific recommendations of this issue. The results of this study are easily applicable in the procedures for administering the Albanian tax system, contributing to a system that is simple to administer and low-cost, which also reduces the possibility of tax evasion.

Keywords: *administrative reform, tax law, income tax, business income, taxation principles.*

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1. Introduction

The ongoing reform of the income tax law in Albania represents a critical and ambitious endeavour to modernise the fiscal framework and enhance economic fairness. Initiated nearly three decades ago, this comprehensive process aims to adapt the tax system to the evolving economic landscape and align it with

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international standards. Such reforms are imperative not only for improving revenue collection but also for fostering a business environment that encourages investment and growth.

Albania's journey towards tax reform has been intricate, addressing sensitive and complex issues that affect both individual taxpayers and the broader business community. Key areas of focus include simplifying the tax code, enhancing transparency, and increasing compliance while minimising the administrative burden on taxpayers. Special attention is being given to the taxation of income from freelancers and small businesses, recognising their significant role in the economy and the unique challenges they face.

The reform efforts are also geared towards reducing tax evasion and ensuring a more equitable distribution of the tax burden. By reevaluating tax rates and thresholds, and introducing progressive policies, the government seeks to achieve a balance where taxation policy supports economic activities without stifling growth.

As Albania continues to refine its income tax laws, the implications of these reforms are far-reaching, affecting every facet of economic life and promising to reshape the fiscal landscape in a way that is modern, efficient, and just.

2. Research method

Albania has made significant strides in recent years with its efforts to safeguard fiscal sustainability, which is essential for macroeconomic stability and sustainable growth. This study provides a theoretical legal analysis of the income tax law in Albania, focusing primarily on the new legal changes related to the taxation of freelancers and small business income. The analysis of this study was based on Law no. 29/2023 'On income tax', which defines the legal framework for income taxation, as well as the rules that apply to tax obligations by individuals and entities according to the definitions specified in the law. In addition to this law, our study also drew on several guidelines from the Council of Ministers, the General Directorate of Taxes, the IMF, etc.; scientific journals with impact factors; and various national and international publications and studies.

To organise the information, a matrix was created that synthesises the following data: author(s), year, source, and abstract from the Web of Science and Scopus databases. The analysis of the selected studies was qualitative, identifying the main concepts, factors, and processes reported in the literature regarding income taxation in Albania. The results are presented descriptively, following a thematic structure.

3. Principles of taxation

The primary and most important function of every state, which is carried out through the government and other public authorities, is the provision of various public services to citizens. These services include national defence, the judicial system, public order, infrastructure, education, etc., and of course, to exercise these functions, significant financial resources are needed, which are largely realised through taxes and duties[3]. Taxes are the fundamental financial instrument for collecting public revenues with which the state covers its expenses in order to meet the needs of society. Therefore, tax is a payment to the state budget that is obligatory and non-refundable, which also includes administrative penalties as well as interest for late payments specified by law.

The tax system should be based on several principles, because different fiscal policy objectives are achieved through the tax system. The doctrine of financial law groups the principles of taxation into two categories: the universal principles of taxation and the constitutional principles of taxation. In capitalist states, the universal principles of taxation are as follows:

1. Taxes should be ***clear*** and understandable to taxpayers and not arbitrarily imposed by the public operator. The principle of accuracy and security is especially important in a rule of law state where the tax burden on citizens must be determined by law and not left to the whim of the public operator. Generally, this principle is met in modern states because taxes can only be determined by the legislature. However, in practice, the financial administration enjoys considerable discretion in decision-making during the verification of taxpayer declarations.

2. The tax system should be ***simple to administer*** so that it has low costs, whether directly for administrators or indirectly for taxpayers, and it should reduce the possibility of tax evasion.

3. The distribution of the tax burden should be ***impartial***, whether in terms of ***horizontal neutrality or as vertical neutrality.*** The tax system should be inspired by principles of neutrality, understood both at the horizontal level as equal treatment of equals and at the vertical level, which requires different treatments for different entities in different situations.

4. The tax system should aim to achieve ***a redistribution of income*** and/or wealth in a direction and to an extent that is considered socially desirable.

5. The tax system should be ***efficient*** so as not to create distortions in the distribution of resources and to correct existing ones.

6. The tax system should meet the requirements for ***stabilising national income*** and should support the implementation of tax policies for this purpose.

7. ***Flexibility***, the tax system should adapt to the development needs of the country[4].

In the category of constitutional principles of taxation, are included in the principle of legality and the ability to pay:

[3] Gjyli K., *Shkenca mbi financat dhe e drejta financiare.* Tirane, 2010, p. 223-227.

[4] Fundamental principles of taxation, OECD iLibrary 2014. Chapter 2, p. 31, https://www.oecd-ilibrary.org/fundamental-principles-of-taxation_5jxv8zhcggxv.pdf, consulted on 10.05.2024.

1. The principle of legality is also sanctioned in the Constitution of the Republic of Albania[5], Article 155, Part XIII, Public Finance: 'Taxes, duties, and national and local financial obligations, the relief or exemption from them for certain categories of payers, as well as the method of their collection are determined by law. In this case, the law cannot be made retroactive effect.' The principle of legality is the basis of compliance with all procedural aspects in qualifying the circumstances of the case, choice, and use of law[6].

2. The principle of ability to pay: The principle of ability to pay is one of the constitutional-financial principles which, together with another constitutional principle, that of legality, constitute the two fundamental constitutional pillars that should characterise the fiscal legislation as a whole. According to this principle, 'Everyone shall contribute to public expenditures in relation to their income,[7]' meaning that every tax subject will contribute to the increase of public revenues in proportion to their ability to pay. The subject cannot pay tax obligations that are unjustified by their ability to pay or by their contributory capacity[8].

4. New regime on income taxation

The year 2023 marked an important year for the reform of the fiscal legislation in Albania regarding income taxation. The new Law No. 29/2023 replaced the previous tax law that had been in effect in our country for more than 25 years, a law that had many unregulated gaps due to changes the financial order had undergone over these years. Legislative deficiencies left ample room for interpretation, often abusively by the enforcers, creating significant dissatisfaction among taxpayers. The same can be said from the taxpayers' side, who in many cases, took advantage of the unclear provisions of the law to create abusive schemes, which in their entirety created the perception that the existing law envisaged unequal treatment of taxpayers. The adverse effect may result for lower tax rates, as people tend to report on higher incomes[9].

The new Income Tax Law has focused not only on strengthening neutrality in the Albanian tax system but also on its gradual alignment with EU Directives. In general terms, through comprehensive legal provisions, it has attempted to address many deficiencies that have troubled taxpayers and tax consultants over the years. Thus, the new law and the guidelines for its implementation have managed to provide legal clarity on a series of issues that have left much room for interpretation in the past.

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[5] Law no. 8417, date 21.10.1998 was published in the Official Gazette No. 28/1998.

[6] Nedbailo P. E. (1960). *The Application of Soviet Legal Standards*. Moscow: State-Publishing House of Juridical Literature, p. 512.

[7] Constitution of the Italian Republic, Article 53.

[8] La Rosa Salvatore, *Principi di diritto tributario*, Giappichelli; 2° edizione, (2006), p. 73.

[9] Gerald Auten and Robert Carroll, 'The Effect of Income taxes on household income,' *The review of economics and statistics*, no. 81 (1999): 14.

The New Income Tax Law is designed to regulate the taxation of individual and corporate income, along with the taxation associated with inheritance, gifts, and income originating from Games of Chance. One of the innovations introduced by the new law, which came into effect on January 1, 2024, was the implementation of significant new changes in the way withholding tax is applied. Additionally, several amendments have been made to the Law on Tax Procedures concerning the procedures for applying Double Taxation Treaties, the relevant deadlines, and applicable penalties.

A very important positive aspect of this law is the clarity it provides regarding points considered evasive in the tax aspect, such as residency, ownership changes, business reorganisations, amortisation, losses, bad debt, and others. For the first time, the new tax law made a clear distinction among three categories of personal income that would be considered taxable. The following incomes are considered taxable income of a personal income taxpayer:

a) income from employment;
b) income from business;
c) income from investments.

A significant part of the legal changes also includes the taxation of freelancers and small businesses. Professionals such as accountants, doctors, and lawyers employed by companies would pay personal income tax under the same rules as other employees. However, if they were to register as self-employed and offer the same services as a business, their tax bills would be much lower and often even zero. In this way, the new tax law was changed to ensure that freelancers would be taxed in a manner comparable to other employed taxpayers, while the favourable treatment for businesses aims to better serve firms and owners engaged in commercial activities.

According to the new Law no. 29/2023 dated 30.03.2023 'On Income Tax', the business income of the individuals (self-employed or entrepreneurs) will be governed by the provisions regulating the section of the Personal Income Tax. The existing Income Tax legislation previously has included the taxation of the business income of individuals based on the compliance rules of simplified income tax. Later on, the taxation of such income has been governed by local taxes legislation whereby the municipalities were the competent authority for the tax collection. With the implementation of the new Law, the governance of the taxes of individual businesses is expected to be shifted to the central tax administration[10].

One of the complexities introduced by the new law involves the intricacies of the relationships it governs, necessitating that taxpayers seek professional assistance. Similarly, its implementation will also demand specialised support. There remains ambiguity around the classifications of self-employed individuals,

[10] Paparisto A., *New Income Tax Law in Albania,* KPMG 2024, https://kpmg.com/al/en/home/insights/2023/09/new-income-tax-law-in-albania-.html, consulted on 10.05.2024.

specifically those who will remain exempt from Income Tax and others whose earnings will be categorised as business income. This represents another drawback in the enforcement of the new legislation.

Among its positive aspects, we can certainly list the administration of revenues. The fiscalisation process, where businesses now report all transactions and activities electronically, has positively impacted revenue collection and the transparency of the entire tax system.

5. Personal Income (*employment income, business income and investment income*) tax rates

5.1. Income from employment

Every benefit received by an individual that is related to employment relationships is considered employment income and is taxed as such, regardless of whether it is named salary, wage, reward, bonuses, allowance, compensation, etc. The main principle for considering something as employment income is that the taxable individual must follow the instructions of the income payer, i.e. the employer, or the person (also in the role of an employer) who has assigned a duty/function, in order to receive the salary/wage/reward/bonus/compensation or allowance, or other similar elements[11].

Within the concept of employment income are included the base salary for time worked or quantity produced, any permanent additions to the base salary such as allowances for position, seniority, difficulty, distance from residence, special nature of work or service, as well as other salary supplements and other rewards. Likewise, income that the individual receives in the form of compensation from a special fund, or from other funds established by various legal or statutory acts of companies, such as the 13th salary, or various payments of this nature, are considered employment income and are consolidated on a monthly basis.

The law follows a progressive taxation order for income by setting annual thresholds for calculating income from employment. For annual incomes up to 2,040,000 Albanian leks, the tax rate is 13%, and above this threshold, the tax rate becomes 23%. This regulation will come into effect starting from January 1, 2025. While making a financial plan for personal finances or family finances, everyone must be careful by evaluating every rule and law knowledge, in order not to conflict with fiscal legislation and to use all the advantages and opportunities it offers, for not paying more than required[12].

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[11] Agim Binaj, Ilir Binaj and Irini Limaj, 'Personal Income Tax Policy Analysis: Albania vs. the United States,' *Interntional Journal of Economics and Financial Issues*, No. 3(1) (2013): 42–49.

[12] Arthur J. Keown, *Personal finance-turning money into wealth,* Seventh edition (Boston: Pearson, 2016), 101–120.

5.2. Business income tax

Business income will be considered as the income of a natural person, the income from interest, dividends, and fees, which are effectively connected with the business; income from the sale of securities; income from leasing a business, regardless of whether the lease involves all or part of the tangible or intangible assets; income from the sale of any type of business assets and liabilities, including the sale of the entire business; capital gains realised from the transfer of business assets and liabilities in a business reorganisation; gifts, grants, or subsidies received by a person in connection with his business; income realised by the natural person for any type of automatic technical or digital service fees; capital gains from the revaluation of business assets when these assets are given as an in-kind contribution to the capital of a company, whether at its establishment or capital increase; income from the extraction or benefit of virtual assets; and income from transactions with virtual assets, which are effectively connected with the business.

The new income tax law provides a tax rate of 15% for taxable annual profits up to 14,000,000 Albanian lek and 23% for amounts exceeding this threshold for self-employed and registered entrepreneurs.

5.3. Tax on investment income

According to Law 29/2023 on income taxation, income derived from dividends, interest, fees, capital gains from the transfer of financial instruments and other securities, capital gains from investments made in a life insurance plan, and returns from investments made in a private pension will be considered as part of investment income. Additionally, capital gains from the transfer of real estate, income from renting out real estate, exploitation of virtual assets, and transactions with virtual assets are considered as investment income (to the extent that they are not classified as business income). Individuals receiving income from any of the aforementioned investment categories are subject to a personal income tax rate of 15%, except for income from dividends, which are taxed at a rate of 8%.

6. Corporate income tax

A corporate income tax is a tax imposed on the net income (profit) of corporations and other business entities[13]. This type of tax is calculated based on the earnings of the corporation after accounting for deductible expenses such as cost of goods sold, salaries, and other operating expenses, as well as allowances

[13] Alex Durante, *Who Bears the Burden of Corporate Taxation? A Review of Recent Evidence*. Tax Foundation, June 10, 2021, https://taxfoundation.org/blog/who-bears-burden-corporate-tax/, consulted on 10.05.2024.

for depreciation. The corporate income tax applies to all taxable corporate incomes. In the Albanian legislation, this regulation is dedicated to a separate chapter in the income tax law, thereby establishing new standards and security for Albanian taxpayers.

According to this law, all entities established as general partnerships, limited partnerships, limited liability companies, or joint-stock companies, as well as all other entities not mentioned above, even when subjected to a special tax regime, will be considered taxable subjects. Enterprises, partnerships, known legal entities, asset management entities or net capital, trusts, and those established by special laws in Albania, will be considered taxpayers for corporate income tax, regardless of their annual turnover. The corporate income tax rate is 15%. Exceptionally, the tax rate for dividends is 8%, without deducting any costs.

The tax base for resident taxpayers includes taxable income sourced both within and outside Albania, whereas for non-resident taxpayers, it includes only taxable income sourced within Albania. In cases where the income for an Albanian resident is sourced from outside the territory of Albania, tax crediting comes into assistance. If during a tax year a resident entity earns taxable income from sources outside the Republic of Albania, the tax due from that entity on this income should be reduced by the amount of tax paid in a foreign country on that income.

7. Taxation of inheritance, gifts, and games of chance income

The tax on inheritances, gifts, and games of chance applies to natural persons and entities that are residents in the Republic of Albania, who receive a gift or inheritance of assets located in Albania or abroad, or earn winnings from gambling activities conducted in the Republic of Albania or abroad; and non-residents in the Republic of Albania, who receive a gift or inheritance of assets located in Albania, or earn winnings from a game of chance activities conducted in Albania. Gifts, in the context of this article, include movable or immovable property or money received without any compensation in exchange[14]. The tax rate for inheritances, gifts, and earnings from a game of chance according to this article is 15%, with no deductions for any costs.

The recent changes to the income tax law have triggered significant debates among professionals, prompting discussions about potentially challenging the law in the Constitutional Court. The core of the debate revolves around claims of infringing on the freedom of economic activities and issues of disproportionality. Critics contend that the law strays from the principle of income-based taxation and introduces distinctions that depend on the type of economic activity, which they see as a violation of fair taxation principles.

[14] Law no. 29/2023 ‘The Law on Income Tax’.

8. Conclusion

The new income tax law represents a pivotal shift in the taxation landscape of Albania. It aims to modernise the tax system and align it more closely with European Union standards, which could potentially enhance economic efficiency and fairness. Despite its objectives, the law has stirred considerable debate among professionals and the broader public. Concerns primarily revolve around perceived threats to the freedom of economic activities and the fairness of imposing tax rates based on the nature of these activities rather than income levels alone. As a response, there may be a need for further review and possible adjustments to ensure that the law equitably balances the principles of economic freedom and fair taxation while fostering an environment conducive to growth and compliance. In conclusion, while the new law sets the stage for significant fiscal reforms, its success will depend on its implementation and the resolution of the ongoing debates to achieve a consensus that supports Albania's long-term economic goals.

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