



National Business Forum

NATIONAL BUSINESS FORUM PERSPECTIVES ON THE ISSUE OF INFORMALITY IN ALBANIA

(POLICY PAPER)

MARCH, 2016

ACKNOWLEDGEMENTS & COPYRIGHT

This policy paper is a product of the National Business Forum (NBF) - a network whose mission is to represent the interests of businesses operating in Albania in dialogue with the public institutions.

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National Business Forum

This study has been prepared by the National Business Forum. The National Business Forum is an open non-formal network of Business Associations and Chambers of Commerce. It was launched on 22 of November, 2013 and was founded by 9 organizations. The members of the forum signed a Memorandum of Understanding and agreed on how to work together on issues of common interest in the framework of the NBF. The mission of the National Business Forum is to represent the interests of businesses operating in Albania in dialogue with the public institutions. The founding members of the National Business Forum are: Albanian Center for Economic Research (ACER), Albanian Constructors Association (ACA), Albanian Chamber of International Trade and Development (ACITAD), Tirana Chamber of Commerce and Industry (CCI), Professional Businesswomen and Handcrafters Association (PBWHA), Albanian Recycling Association (ARA), Albanian Chamber of Facon, Albanian Tourism Association (ATA). Website: www.nbf.al



This study has been prepared under the support of the Center for International Private Enterprise (CIPE), in the framework of the programme: Albania: Building an effective public-private dialogue. The Center for International Private Enterprise (CIPE) strengthens democracy around the globe through private enterprise and market-oriented reform. It is one of the four core institutes of the National Endowment for Democracy. CIPE has over 30 years of experience conducting more than 1,300 reform programs in over 100 countries around the world. Key program areas include enterprise ecosystems, democratic governance, business advocacy, and anti-corruption and ethics.

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ABBREVIATIONS

BEEPS	BUSINESS ENVIRONMENT AND ENTERPRISE PERFORMANCE SURVEY
CIPE	CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE
EBRD	EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT
FIA	FOREIGN INVESTMENT ASSOCIATION
GDP	GROSS DOMESTIC PRODUCT
GTD	GENERAL TAX DIRECTORATE
INSTAT	ALBANIAN INSTITUTE OF STATISTICS
NBF	NATIONAL BUSINESS FORUM
WB	WORLD BANK

EXECUTIVE SUMMARY

This policy paper is a result of the joint work and continuous collaboration of the members of the National Business Forum, a non-formal network of chambers and associations in Albania. The Forum is supported by the Center for International Private Enterprise (CIPE) as part of the program: “Albania: Building an Effective Public – Private Dialogue”. The National Business Forum decided to tackle the informality issue as the main priority identified by the business community and by government as well, in 2015, which had a great impact to the registered businesses operating in Albania. This issue was chosen to be tackled, based on the continuous consultation with the NBF members. The identified problems and the proposed recommendations are built with the suggestions of the Forum, their members, and other stakeholders which have been part of the consultation process. A survey with 400 businesses which belongs to different sectors of the economy and size, was conducted during the period of August-September, 2015.

The National Business Forum members have developed a series of recommendations to be considered by the public institutions dealing with informality. The main recommendations of the National Business Forum in order to foster formalization and to improve the business climate in Albania are as follows:

A. In the context of tax burden and the businesses motivation to pay taxes the NBF proposes:

1. Reduce the tax burden and increase the motivation of businesses to pay taxes

Albanian surveyed businesses have admitted that the main reasons why they don't feel motivated at all to pay taxes are: (a) the high level of taxes; (b) the continuous tax inspections and the bribes they give to inspectors that somehow encourages them to hide profits / income, thus paying less taxes; (c) the lack of qualitative public services that they expect to receive as a result of taxes paid.

Hereof the National Business Forum proposes:

(a) Taking into consideration the reduction of taxes, accompanying this with a sectoral analysis where certain sectors should have a specific tax. Some specific recommendations about taxes that come from the NBF, are presented as below. For the agriculture sector, the NBF proposes a reduction of VAT to 8%, profit tax to 0 %, social insurances to 10 %. For the tourism sector, the NBF proposes a reduction of VAT to 8 %, profit tax to 10%, social insurances to 10 %. For facon sector, the NBF proposes a reduction of VAT to 0 %, profit tax to 5%, social insurances to 5 %;

(b) Design a long-term pact between the government and chambers of commerce / business associations in order to work together on the formalization of the economy, instead of frequent continuous tax inspections of tax administration - working together with businesses stimulating them to become formalized through awareness campaigns, providing consultations to various businesses in need, etc.

(c) Government should prove to citizens / businesses that their taxes are important and that they go to fund important public services. This might be done using different channels of

communicating to citizens about where their money is spent. For instance, the government should publish videos on TV about what happens with the taxes they pay. In addition, street banners might be used on this purpose.

2. Improving transparency and accountability of the tax administration

According to the survey results, businesses acknowledge that there is a lack of a real consultation by the government in the framework of decision making process about the business legislation/taxation.

Hereof the National Business Forum proposes:

a) The tax authorities should publish an annual report about their services, at latest at the end of March of the following year. Annual reports must be accessible online and should contain key indicators of the administration performance, the number of tax inspections, the number of fines, legal tax packages, cases won / lost, etc.

b) (i) Each piece of tax legislation must be consulted seriously (not just for a public show) with stakeholders (business community and representatives of the community) and all the stakeholders' comments should be published as well;

(ii) Each revised piece of secondary legislation should be published at least 30-days before it takes effect, and in case it is not published, businesses should not be required to comply with it.

3. Increasing the sustainability of tax legislation

According to the study, most businesses recognize that the lack of consistency and continuous changes of tax legislation is not leaving time to businesses to become familiar with the changes and comply. 53% of surveyed businesses admit this.

Hereof the National Business Forum proposes:

a) Increasing the stability of tax legislation in order to avoid problems when adapting changes. The tax legislation changes should be preliminary consulted with the business community in order to get their inputs which will increase the sustainability of the legislation;

b) Improving the organizational capacity of tax administration employees by conducting training by the Fiscal Academy or informative sessions in order to increase the efficiency and effectiveness of their work;

c) Informing businesses about the legal changes and providing the necessary support to understand the changes made, especially for micro and small businesses.

B. In the context of labor compliance, NBF proposes:

1. Application of the proportionality principle regarding fines imposition in cases of undeclared workers

According to the survey findings, on average 29% of the total workforce is not reported to tax authorities. The government increased the fines for the violation committed by businesses, which led to the worsening of the situation.

Hereof the National Business Forum proposes: the proportionally principle needs to be taken into consideration when setting penalties for the non-declaration of workers. The level of penalty should vary depending on the size and category of business and it should be proportional to the violation of labor legislation.

2. Reviewing the level of taxations on salary income

According to the survey, the businesses admitted that the average level of employees' salaries that are evaded (are paid in cash) from taxes is reported to be 43 %.

Hereof the National Business Forum proposes: Reviewing the taxation level for salary income in order to formalize this component and create favorable conditions for foreigners working in Albania, attracting them with a more favorable tax system for paying taxes in Albania.

C. In the context of tax inspection problems, NBF proposes:

1. Improving the professional and ethical standards of tax inspectors

A big part of surveyed businesses (47%) admit that both parties take the initiative to seek or give bribes, while 38% of surveyed businesses claim that tax inspectors ask first for bribes in order to facilitate the process of tax inspection.

Hereof the National Business Forum proposes: Improving the professional and ethical standards of tax inspectors during the interaction with businesses, considering that the damages that a tax inspector can cause to a business activity are potentially very high. Thus, a mandatory training program for tax inspectors should come up from the Fiscal Academy.

2. Reducing the amount of prepaid fines to 10% of the amount of the tax duties (currently 100%)

Another issue of concern is the "*high level of fines for tax violations*" which is pointed out by 50% of surveyed businesses. Also they declared that most of these fines are imposed in an abusive manner and the biggest problem lies in the fact that for appealing these cases, the business is required to pay initially 100% of the fine.

Hereof the National Business Forum recommends: The amount of the prepaid fines to be reduced to 10% of the amount of the tax duties, as provided in the assessment notice.

3. The selection of taxpayers, subject of tax inspection, should be made only on the basis of risk assessment system.

According to the survey findings, it is evident that the frequent visits of tax inspectors are a very big problem because they prevent the normal progress of business activity - 90% of surveyed businesses had had a tax inspection last year.

Hereof the National Business Forum recommends: The selection process should be administered only automatically, according to the integrated computer system data and results, based on the risk assessment analysis. In addition, businesses have the right to know the criteria taken into account when assessing risk, so it is recommended the publication of these criteria in order to increase the transparency of the selection process.

INTRODUCTION

The National Business Forum is an open informal network of Business Associations and Chambers of Commerce. It was founded on 22 November 2013 by 9 organizations. The mission of the National Business Forum is to represent the interests of the businesses operating in Albania in dialogue with the public institutions.

The goals of the National Business Forum are as follows:

- To find a common language of all members and to increase the presence and visibility of the Forum among businesses.
- To strengthen the role of business organizations in the dialogue with public officials.
- To initiate new policies to improve the business environment.

The National Business Forum currently consists of eight founding members¹ and two partners.² The founding members of the National Business Forum are: Albanian Center for Economic Research (ACER), Constructors Association of Albania (ACA), Albanian Chamber of International Trade and Development (ACITAD), Chamber of Commerce and Industry of Tirana (CCI), the Women Association (SHGPAZ), Albanian Recycling Association, the Chamber of Facon of Albania (CFA), Albanian Tourism Association (ATA). The American Chamber of Commerce in Albania (AmCham) and Albanian Association of Banks (AAB), are partners of the Forum.

After the creation of this network, the members of the Forum agreed to work together on specific issues which have a great impact on the business community in Albania, in a specific period of time. Thus, the National Business Forum members identified and agreed upon some priorities based on their impact on the business community and on the business climate overall. In 2014, the National Business Forum decided to tackle the issue of tax inspection as a priority for 2014. For this reason it was conducted a study and the Forum members developed a set of recommendations and engaged in advocacy to relevant public officials to address the tax inspection issue.³ In early 2015, the National Business Forum members, after various consultations with the business community, agreed to tackle the issue of informality.

The Forum members considered this issue to be of high importance for the business community, for the following reason:

- Based on information provided by all members of the Forum, it was concluded that the business community was very concerned by the unfair competition from businesses that are totally informal (unregistered). In addition, it was concluded that there is a large number of businesses that don't declare their employees, or under-declare them, that hide or conceal the real sales or the real annual profits. In this regard, the Forum experts analyzed the situation and identified the main reasons for this situation, in order to provide possible solutions for addressing these issues which would lead to the reduction of the level of informality and the

¹ The founding members are those who have signed the Memorandum of Membership on 22 November 2013.

² Partners are those who have not yet signed the Memorandum of Membership but they support the Forum.

³ http://www.nbf.al/images/Implementation_Gaps_in_Tax_Inspections_of_Private_Businesses_in_Albania.pdf

improvement of business climate. This document contains specific solutions and recommendations and the Forum members are planning to use it in the advocacy process with public institutions.

The issue of informality is a major concern for businesses operating in Albania. After the NBF decided/announced that it would tackle this issue, simultaneously the Government of Albania decided to consider it as a priority for 2015. Thus, at the beginning of 2015 the Ministry of Economy officially announced that it was planning to draft a strategy for the reduction of informality. The real action of the government against informality began in September 2015. The analysis of this study is done taking into consideration the bottom-up perspective, meaning that the business community gave their inputs and approach on the barriers of doing business that appear as obstacles of getting formalized.

This study is organized as follows:

Chapter 1 describes the definition of informality and the approach that NBF has agreed to take into consideration while preparing the study.

Chapter 2 describes the methodology used to develop this study. This section provides information on the instruments used for the preparation of this study.

Chapter 3 includes the presentation of the findings of the survey conducted with 400 businesses in Albania. This chapter describes the challenges of doing business in Albania from business perspective, the barriers of formalization and the incentives for formalization.

Chapter 4 emphasizes the main findings of the study and presents the proposed recommendations by the National Business Forum.

I. DEFINITION OF INFORMALITY

Addressing informality issues in Albania requires the provision of a working definition and the proposal of direct and indirect instruments for measuring it. The World Bank's definition makes a distinction between: a) "survival business activities" including casual jobs, temporary jobs, unpaid jobs, subsistence agriculture, multiple job holding" and b) "illegal business activities" including unofficial activities such as tax evasion, avoidance of labor regulation and other government or institutional regulations, no registration of the company, also inclusive of "underground activities" dealing with corruption, and crime activities not registered by the statistical office.⁴ Therefore, the WB definition focuses more on the causes and composition of the informal sector.

The European Commission, on the other hand, focuses more on undeclared work, which it defines as "any paid activities that are lawful as regards their nature but not declared to public authorities, taking into account differences in the regulatory system of Member States." This definition covers diverse activities while excluding criminal activities, and underscores the policy focus of the EC on labor rather than taxes.⁵ In principle, activities that are performed in the informal economy are not included in the gross national product (GNP) and the gross domestic product (GDP), as they are not monitored by any government (national or regional and local) though often what is not disclosed for tax and regulatory purposes might be captured (at least) partially by statistical methods.

In the academic area, one of the most influential books on the informal economy is Hernando de Soto's "The Other Path" (1986), where the author argues that excessive government regulation forces a large part of the economy into informality and thus prevents economic development, where by excessive regulation he means all administrative procedures, costs and time needed to register and formalize a private enterprise. Other authors such as Schneider and Williams (2013), talk about a hidden/shadow economy, which "includes all market-based production of legal goods and services that are intentionally hidden from public authorities for the following reasons: to avoid payment of income, VAT or other taxes; to avoid payment of social security contributions; to avoid having to meet certain legal labor market standards, such as minimum wages, maximum working hours, safety standards, and to avoid complying with certain administrative obligations".⁶

The most widely used terms to describe the phenomenon in Albania are 'grey' or 'informal' economy. These are utilized by the public institutions in their strategic documents⁷, the media and most of the research studies conducted by academia and civil society. Most commonly informality is defined as "those economic activities which are legal, but are (intentionally) unregistered for tax purposes".⁸ The definition refers mostly to a government approach

⁴<http://lnweb90.worldbank.org/eca/eca.nsf/1f3aa35cab9dea4f85256a77004e4ef4/2e4ede543787a0c085256a940073f4e4>

⁵ CSD Background Study in Macedonia

⁶ Schneider, F., Williams, C. (2013) "*The Shadow Economy*", The institute of Economic Affairs 2013, pp 23-27, Retrieved on 01.06.2014 from:

<http://www.iea.org.uk/sites/default/files/publications/files/IEA%20Shadow%20Economy%20web%20rev%207.6.13.pdf>

⁷ Business and Investment Development Strategy 2013-2020 and National Strategy for Development and Integration 2013-2020

⁸ Government of Albania, Business and Investment Development Strategy 2013-2020, Official Draft published

focusing more on the budget revenues impact of informality, which often leads to adopting predominantly punitive measures to tackle informality. This is the case of the National Strategy for Business and Investment Development 2013 – 2020, which introduces as its main efforts to reduce informality the following actions: “improve cooperation between inspection bodies and employment services with police and tax structures”.

However, different Albanian public institutions or entities define informality slightly differently based on the purpose they seek to address, still using the same principle of un-recorded economic activity. As such, the National Strategy for Development and Integration 2013 - 2020 addresses informality through corrective measures, such as a) improve fiscal management aiming at reducing informality through simplification and computerization of procedures, and b) promote formalization of jobs through incentives and more flexible contracts.

For the purposes of this policy paper, we based the definition of informal economy upon the most adequate theories used worldwide, which are also adaptable to the country specific economic development and to the specific sectors in which the National Business Forum (NBF) has the most representation. The definition most applicable to the economic practice in Albania is the WB one, as it is tailored for less-developed, lower income economies, where the informal sector has an important role in alleviating poverty by creating jobs, though low paid and with poor job security, but without focusing on survival and on underground activities. Thus this paper’s focus is on analyzing informal activities related to tax evasion, lack of business registration, and labor regulation avoidance. Such forms of informal economy are the most detrimental to economic development, and seem to be more present in countries that yet are undergoing structural reforms and transitional economic adjustments, such as Albania. Moreover, some elements of De Soto’s definition are considered. There is an ongoing debate of private businesses and academia in Albania, which takes into consideration the role of over-regulation risks in causing informality in the economy of the country, especially in a period of economic downturn.⁹

Based on the different approaches of tackling informality, the National Business Forum (NBF) has decided to focus its efforts on three main pillars of informality in Albania:

- Fully undeclared employees – those who do not have any contract at all;
- Under-declared employees – those who receive envelope wages, declaring only part of their salary;
- Under-declaring real annual revenue/profit.

on June 2013, Expected to be finalized by end of 2015, Accessible at: http://shtetiweb.org/wp-content/uploads/2014/06/NSDI_2014-2020_version_JUNE-2013.pdf

⁹ <http://www.fondacionifle.al/>

II. METHODOLOGY

This study aims to look at barriers to doing business that are obstacles to formal operations. In order to provide relevant recommendations to tackling these barriers, the study first aims at measuring the level of some aspects of informality, and then at analyzing the root causes for this state. For measuring the level of informality and providing the appropriate proposals, this study used both qualitative (desk research) and quantitative (survey) research methods.

The desk research involved the revision of all relevant policy documents and regulatory acts. It is necessary for providing a background of the Albanian context and for conducting an efficient field work based on current developments in the sector.

2.1. Desk Research

In order to better understand the informality approach in Albania, it was necessary to review:

- A number of papers, including reports of the World Bank, studies conducted in other countries on informality, studies conducted in Albania on businesses' barriers, and other statistical reports of relevant institutions;
- The legal framework;
- Studies related to surveys and questionnaire drafting, aimed at identifying the best practices for indirect and direct questions, which would increase the level of honesty of the respondents and make the study more reliable.

2.2. Survey

This paper is based on a survey that targeted 400 businesses operating in Albania, which consist of different sectors and sizes. The survey was conducted during the period August-September 2015, which coincided with the start of government action against informality (which started at the beginning of September). The survey method used was face-to-face interviews with the respondents. The response rate was 80 %. The instrument used for data collected was a questionnaire which includes five sections. The questionnaire was designed based on an extensive literature review, and consultations with business experts and business representatives. The questionnaire includes questions on the business perception on the overall state of the economy and business climate. In addition, they were asked about their specific experiences with some aspects of informality. The questionnaire was initially tested with businesses and was further improved after its testing. The survey was conducted with individuals holding a limited number of positions within the company,¹⁰ as they are better informed and have the permission to share data which are considered sensitive/and share their experiences and their perspectives. Most interviews (43 %) were carried out in Tirana as most of businesses (47.5 %) have their business activity in Tirana (INSTAT, 2014). Business were chosen randomly from the existing General Tax Directorate (GTD) data base, at the confidence interval 95 percent and a team of 20 interviewers were engaged for conducting the survey.

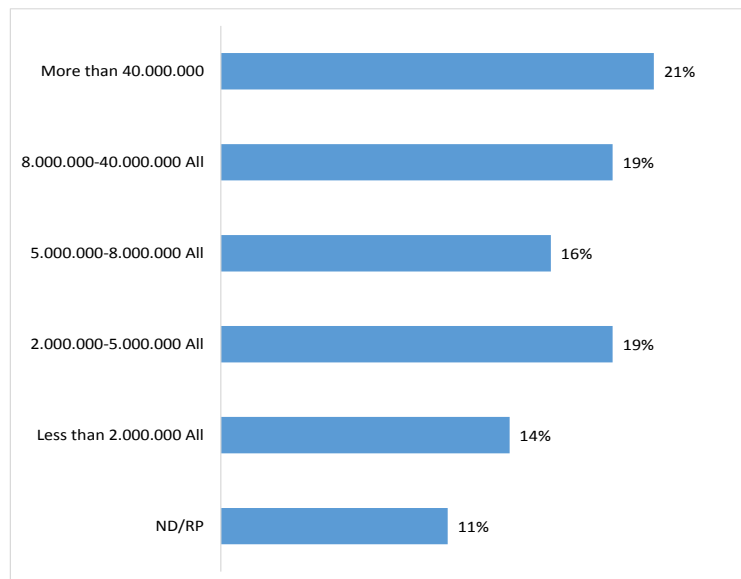
¹⁰ Owner / Partner / Shareholder, Manager / Executive Director, Financial Director / Chief Accountant

2.2.1. Demographic Data of the Survey

This section will provide an overview of the main characteristics of the surveyed businesses, in order to understand their profile according to the type of ownership and legal status of the companies, year of creation, operating markets, industries and main economic activities, size of the firm by number of employees and their annual turnover.

Based on the survey results, the majority of respondents (53 %) belongs to the position of Owner / Partner / Shareholder, 30% of them are managers or executive directors and 17% financial directors / Chief Accountants. 44% of the surveyed businesses' representatives are females and from these latter 43% are owner / partner / shareholder. The sample size was 400 businesses, being proportionally based. It covered all the sectors of the economy (industry, services, agriculture, forestry, fishing, construction, transport and storage, hotels and food service; information and communications; other services; trade). 26.2% of surveyed businesses were micro companies, 24.4% small companies, 26.4% medium companies and 22.9% large companies.¹¹ In terms of legal status, 56.8% of the surveyed businesses are "juridical persons", and 42.8% are businesses with a single owner, "physical person". With regard to the annual revenues, for the last fiscal year (2014), most of the surveyed businesses (49%), have an annual revenue of up to 8,000,000 All; for 19% of them their annual revenues are 8,000,001 All - 40,000,000 All, and only 21% have an annual revenue of more than 40,000,000 All. This indicator shows once again that the market is dominated by small companies with annual revenues not more than 8,000,000 All and with a labor force of 1-9 employees. It should be noted that, last year (2014) there is an increased trend of the annual turnover of the surveyed companies, and this is stated by 39% of respondents, while the revenue has declined or appears to be "unchanged" for 56% of them.

Figure 1. Annual Revenues for Year 2014



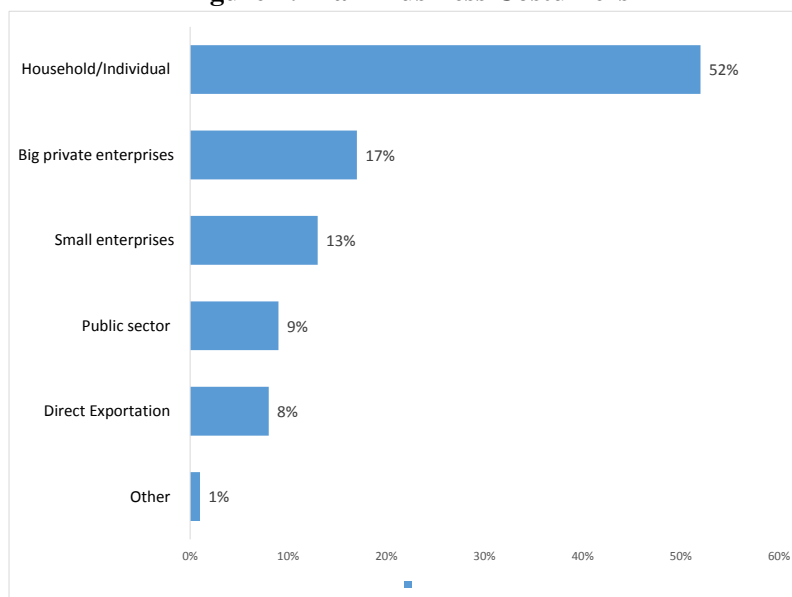
Source: Authors' calculations based on the survey

¹¹For the businesses category according to the size of the business it is taken into consideration the number of employees. According to INSTAT the categorization is: 1-4 (micro), 5-9 (small); 10-49 (medium), 50-more (large).

In terms of distribution of respondents by economic sectors, the trade sector dominates with 24.8%; services with 21%; manufacturing with 19%; accommodation and food services with 15.8%; and less in the transport and storage sector by 7.5%, construction with 7%, as well as agriculture, forestry and fishing with only 3%.

This representation of the sample is in line with the structure of economic sectors on the national level, according to the Trade Register where the dominant sectors in the economy are trade (c), services (d) and industry (v), with a declining trend of the construction sector (o) (INSTAT, 2015). The majority of surveyed companies (52 %) admit that "family/final consumers" are those that generate more revenue for businesses, while the public sector is seen as an increasing contributor for 9% of them.

Figure 2: Main Business Costumers



Source: Authors calculations based on the survey

As for participation and activism in business associations, only 22% of the surveyed companies declare they are members of at least one association in their relevant economic sector. About 76% of the enterprises operate in a strong lack of participation in interest groups, such as business associations, which serve not only for advising but also advocating to governmental institutions on issues of business development.

III. FINDINGS OF THE SURVEY

3.1. Doing Business Climate

The latest report "Doing Business in Albania 2016" ranked the country 35 places lower than the previous year (2015) evaluating it on the 97th position out of 189 world economies and among the last in the Balkans.¹² Among the main factors behind the deterioration of this indicator, are estimated to be the lack of construction permits, tax payments, difficulty in obtaining a loan, issues of ownership as the main obstacle in doing business in Albania (Doing Business, 2016). Although this survey was conducted in August-September 2015 while the actions of the Albanian government to combat informality were not materialized yet in inspections and controls on tax evasion, some data from this survey can serve to analyze the climate of doing business in 2015. From an overall perspective of the latest developments in the socio-economic environment, respondents were asked to give a perception on the "direction of the country, if things are going in the right direction or not."

When asked in general about the country's direction, the findings show that the perception of businesses is relatively positive, since 38.8% of the survey participants claim that "in general, the country is moving in the right direction", with a slight difference from the 34.3% of those who are neutral, agreeing that the direction of the country is "a little of both". 23.5% of the respondents have a negative perception that "the country is going in the wrong direction."

In general, the business community tends to be optimistic on the development perspective of the country. The main impact of this variable appears to be the forecasts of surveyed businesses on the economy in general and in the climate of doing business, in particular for the next 6 months. When asked about business conditions and their impact on the economy in the next 6 months, 39% of them expressed a positive perception that the economic situation will be "somewhat better" and "a lot better", with a small difference from the respondents that see the business climate "almost the same" (33%). Meanwhile, only 27% of the respondents claimed that in the next 6 months, the business climate will be worse.

3.2. Obstacles to Doing Business in Albania

Surveyed businesses were asked about the main challenges they face in their daily activity, to be in compliance with laws and government policies. It was concluded that the three most serious problems / very serious, are:

- **'too high taxes'** for 66% of them,
- **"too much competition from other businesses which are not registered "** for 64% of respondents and,
- **"too little information about government programs that might help registered businesses"** for 43% of the surveyed businesses. (Figure 3)

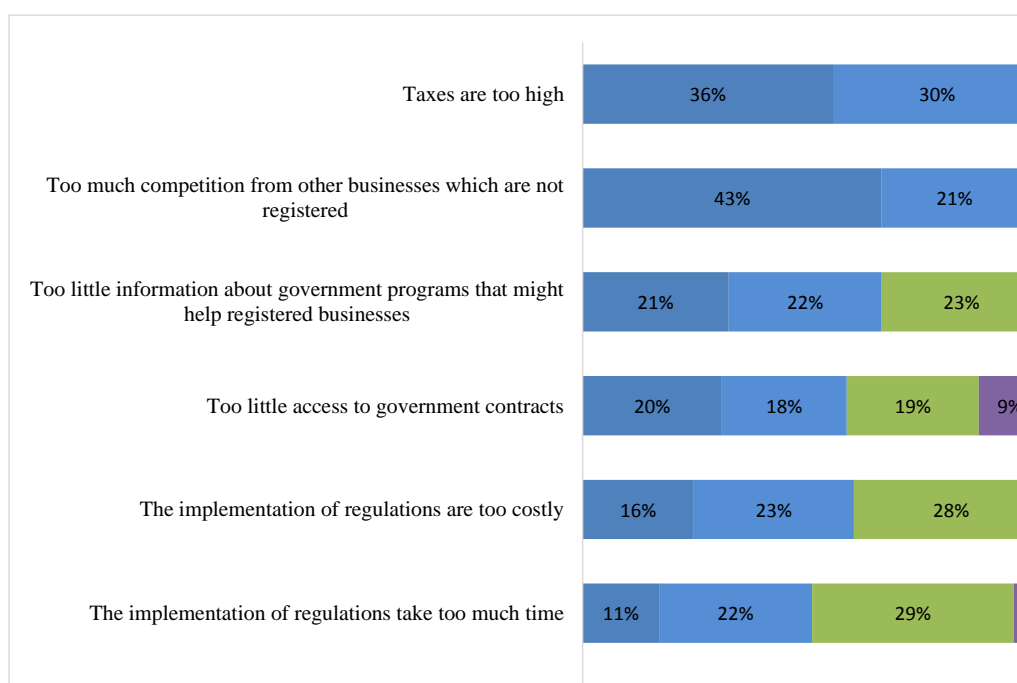
¹²World Bank 2016; *Doing Business 2016*. Available at:

<http://www.doingbusiness.org/data/exploreeconomies/albania/~media/giaeb/doing%20business/documents/profiles/country/ALB.pdf>

The latest report of the World Bank supports the above result related to taxes. The tax payment is listed among the main problems also in the World Bank "Doing Business 2016" report.¹³

One of the primary constraints cited by businesses is **unfair competition of other businesses that are not registered (informal)**, fully confirmed by another question of the survey: "How much of an obstacle are practices of your unregistered competitors to the current operations or economic success of your company?" **64% of businesses have recognized that this is a very severe/major obstacle.** The problem of unfair competition is also confirmed by the study conducted by the Foreign Investors Association in March-April 2015, where 56% of surveyed businesses have admitted that "unfair competition" is a "serious/very serious" problem.¹⁴ The study conducted by the EBRD (the survey was conducted in 2013)¹⁵ shows as well that "competitors practices in the informal sector" is one of the three main business obstacles, where 40.2% of the surveyed businesses reported that they compete against unregistered entities.

Figure 3. Main Challenges of Businesses



Source: Authors calculations based on the survey

Businesses were also asked about the problems they faced in the interactions with the tax administration. According to survey results, **61% of businesses admit that working with the tax administration constitutes "Financial costs for Business"** and it is estimated to be a severe/major constraint. **53% of surveyed businesses admit that "the lack of consistency and continuously changing regulations" stand to be a burden and 50% of businesses admit that "the level of tax penalties imposed for violations" is a severe/major burden for their business.** (Figure 4)

¹³World Bank 2016; *Doing Business 2016*. Available at:

http://www.doingbusiness.org/data/exploreeconomies/albania/~/_media/giaeb/doing%20business/documents/profiles/country/ALB.pdf

¹⁴Foreign Investors Association 2015, *Business Environment*, The full study can be found here:

http://issuu.com/armand22/docs/fiaa_business_environment_survey_20

¹⁵EBRD 2015, *Business Environment and Enterprise Performance Survey (BEEPS) (2013)*.

The above conclusions are in line with other studies conducted (FIA 2015) on the issues of businesses working with the tax administration. According to the FIA study (Business Environment, survey, 2015) "Continuous changes in tax legislation " represent a great/ large problem in 53% of surveyed businesses.

Figure 4. Main Concerns Regarding the Tax Administration

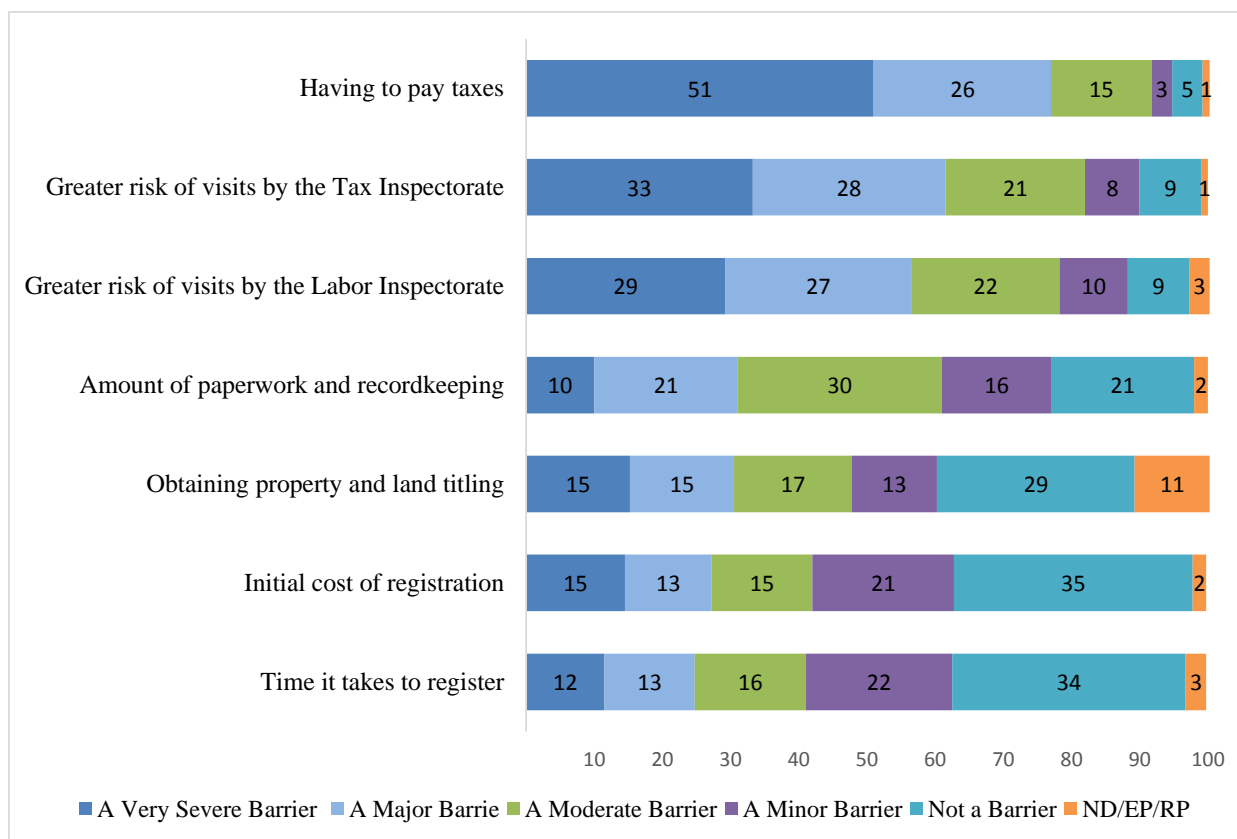


Source: Authors’ calculations based on the survey

3.3. Benefits and Difficulties in Getting Formalized

When talking about the main obstacles to doing business, **unfair competition** from businesses that are unregistered, was flagged by the majority of surveyed businesses (64 %). In this regard, one of the objectives of this study was to analyze the main reasons why businesses are not registered, hence to become formally recognized as a competitor in the sector and that will equally compete in front of tax authorities. Surveyed businesses estimate that the three major reasons that prevent unregistered businesses to become registered are: **“Having to pay taxes” (77 %)**, **“Greater risk of visits by the Tax Inspectorate” (62 %)** and **“Greater risk of visits by the Labor Inspectorate” (57 %)**. Figure 5.

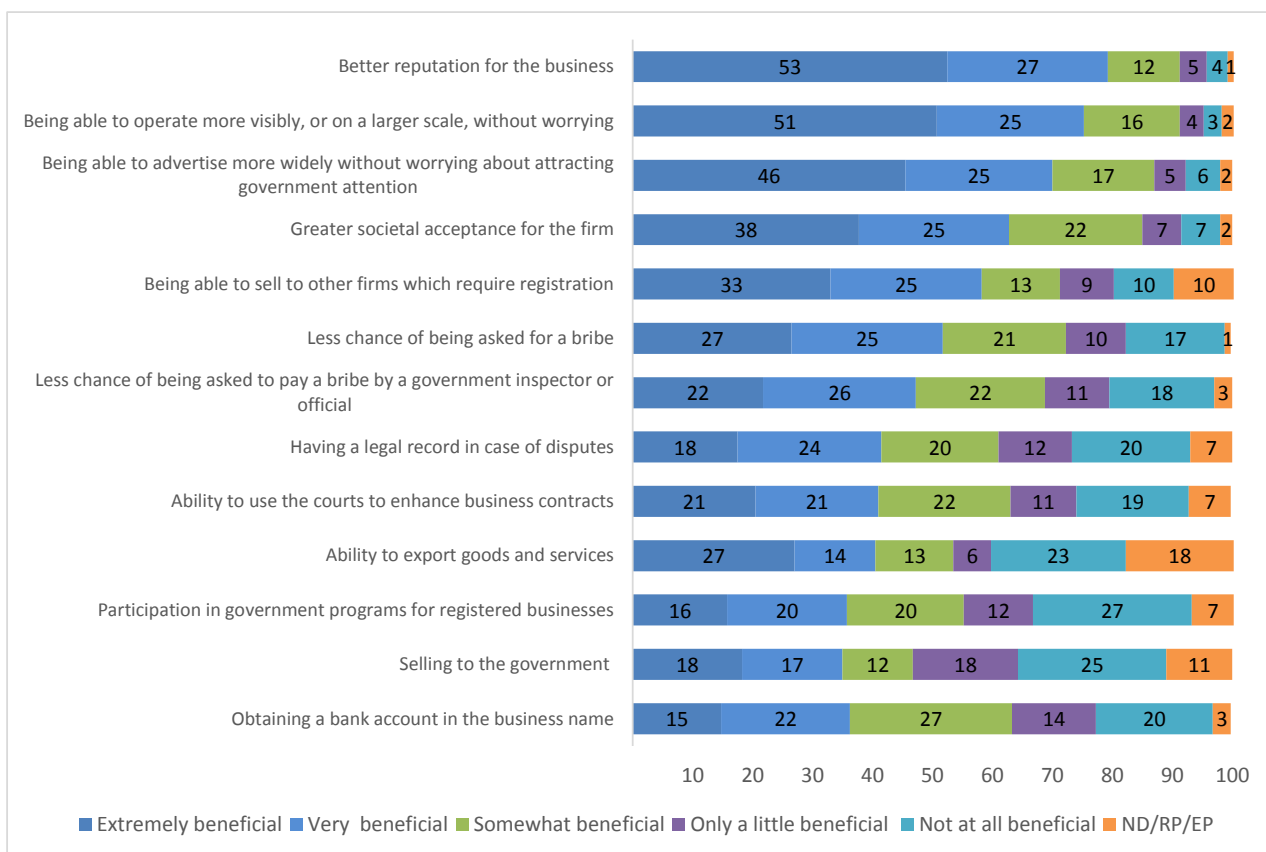
Figure 5. Obstacles which Prevent Businesses Registration



Source: Authors calculations based on the survey

The surveyed businesses were also asked about the benefits that a business has from being registered. From the list of the potential benefits, businesses have estimated that the three most important benefits are "Better reputation for the business" (80% rated this as extremely beneficial and very beneficial); " Being able to advertise more widely without worrying about attracting government attention " (76% of respondents approved the statement); and "Greater societal acceptance for the firm", (claimed by 71% of surveyed businesses). As seen in the corresponding chart, the three benefits of being registered evaluated as less profitable, are: " Participation in government programs for registered businesses" (36%), "Selling to the government: (35%) and "Obtaining a bank account in the business name" (37%). This result suggests that the government should take incentives to facilitate all new registered businesses for a specific period of time. Figure no. 6 lists the potential benefits that a registered business has by importance.

Figure 6. Benefits Coming from the Registration of the Business

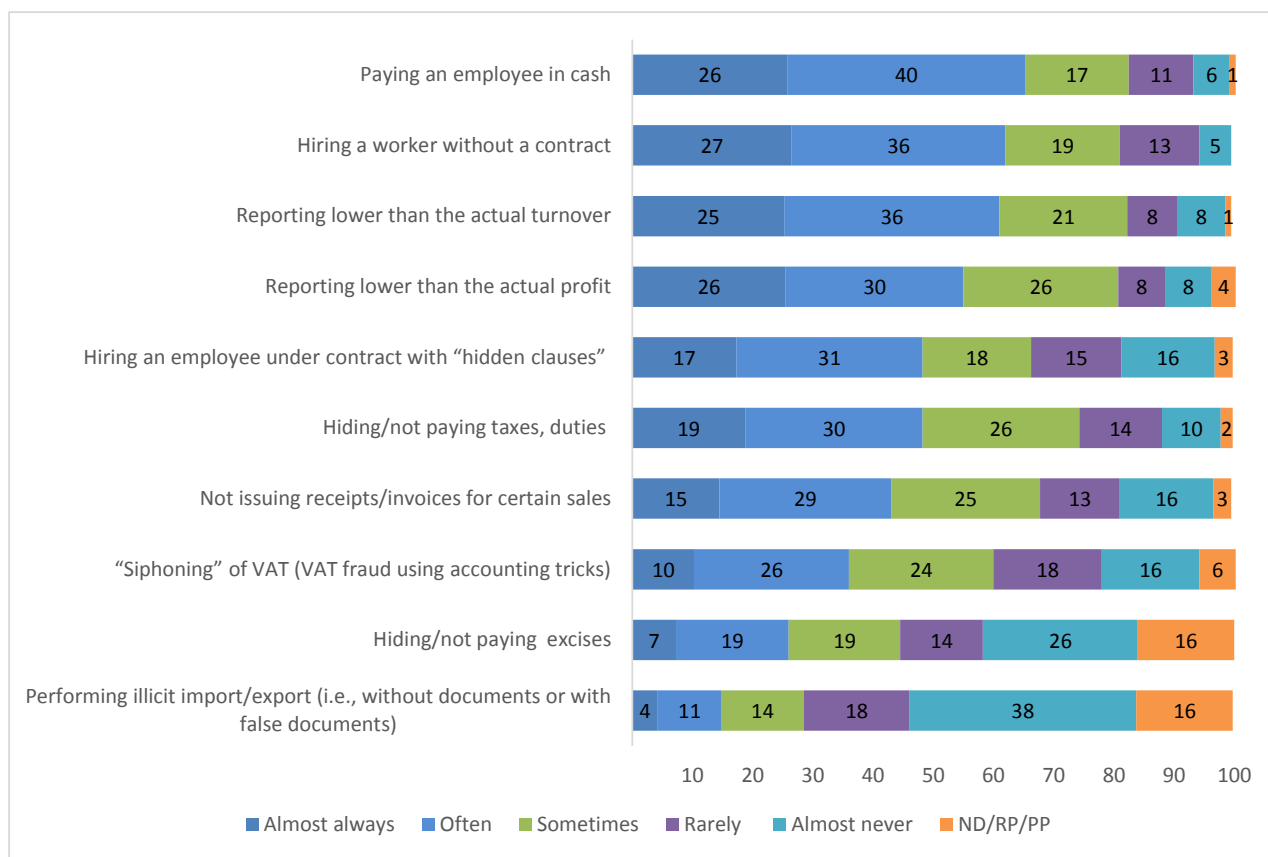


Source: Authors calculations based on the survey

3.4. Informal Practices among Registered Businesses

The informal practices vary depending on the economic sectors. Registered businesses were asked about the level of some aspects of informality. According to the survey results, the majority of businesses (66%) consider that the practice “Paying an employee in cash” happens almost always and often, “hiring a worker without a contract” happens “almost always” and “often” for 63% of surveyed businesses, “Reporting lower than the actual turnover”, happens “almost always” and “often” for 61% of businesses and “Reporting lower than the actual profit” for 56% of them. These are presented in detail in Figure no. 7.

Figure 7. Informal Practices among Registered Businesses



Source: Authors' calculations based on the survey

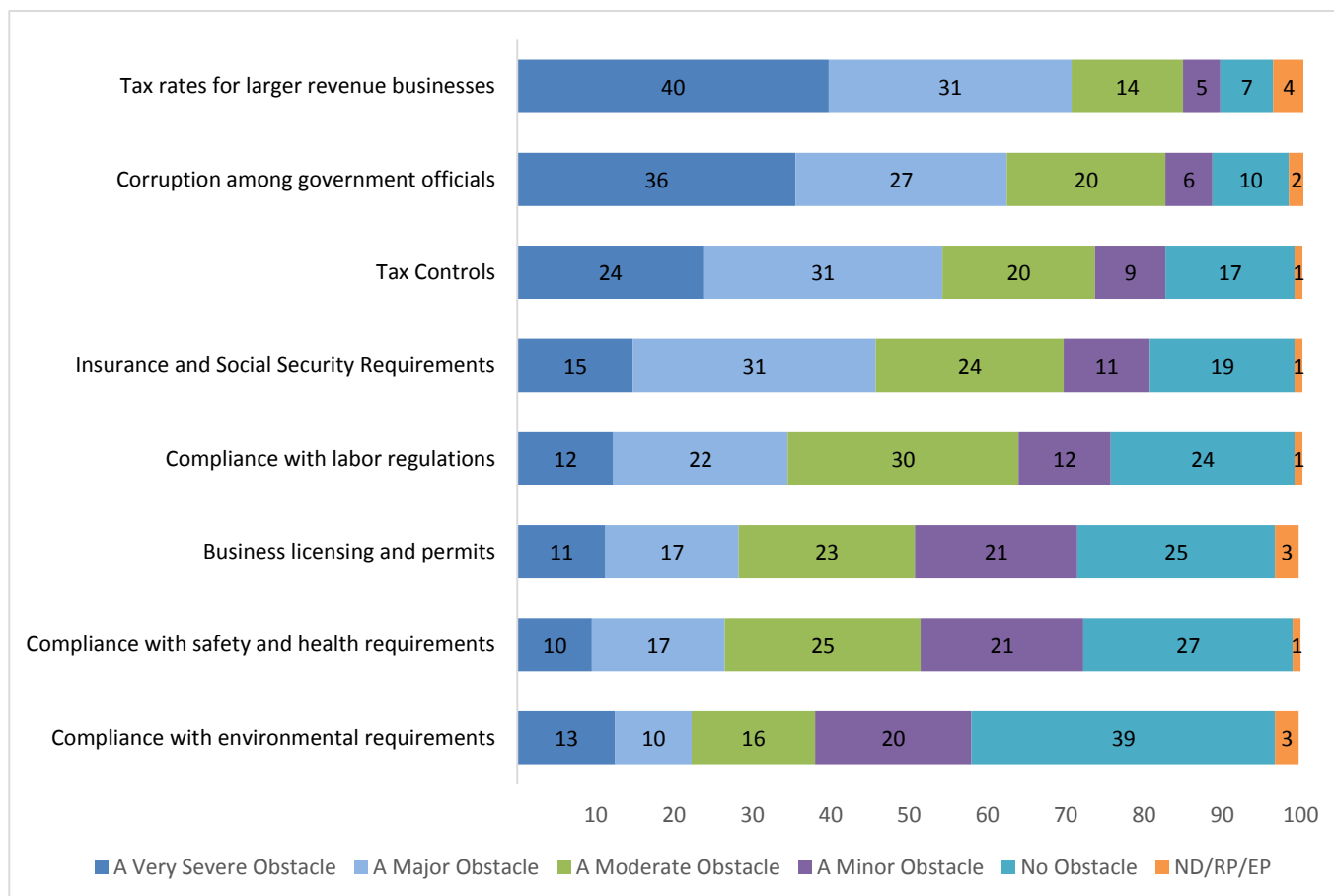
When asked about the main reasons that prevent businesses from operating in full transparency, they listed the three biggest obstacles to be: **“Tax rates for larger revenue businesses”** cited by 71% of the surveyed businesses as a very severe/major obstacle; **“Corruption among government officials”** for 63% of the businesses and **“Tax Inspection”** for 55% of them. The aspects which have been considered less problematic are: “Compliance with environmental requirements”, “Compliance with safety and health requirements” and “business licensing and permits”. In details, this is presented in Figure no. 8.

A corruption approach arises in the relationship between the business and the tax inspector. Businesses were asked whether business owners are the first who try to bribe tax inspectors to gain undue advantages, or tax inspectors are the ones who seek illegal payments. The majority (47 %) of surveyed businesses admit that both parties take the initiative to seek or give bribes, while 38% of businesses admit that the inspectors are the ones who seek first bribe from the company to provide this latter with facilities in the process of tax inspection. This high involvement of business in bribery shows the lack of faith in officially solving problems and increasing conviction that the use of bribes / gifts can radically change the outcome of a tax inspection report. Similar studies conducted with businesses identified corruption as one of the three main problems of the business community today.¹⁶ With regard to the tax inspection, businesses were asked if they had a tax inspection in the last year, and 90% of surveyed businesses gave a positive answer. Moreover, the issue of tax inspectors' visits is estimated to be one of the problems of businesses for 39% of the respondents (Figure

¹⁶EBRD 2015, *Business Environment and Enterprise Performance Survey (BEEPS) (2013)*.

no. 4). Another study conducted by the National Business Forum (2014) on tax inspection,¹⁷ showed that the frequent visits of tax inspectors represent a problem. This shows that very few improvements have been made in this regard, during the last year.

Figure 8. Main factors which prevent businesses to be fully transparent



Source: Authors calculations based on the survey

3.5. Tax Evasion

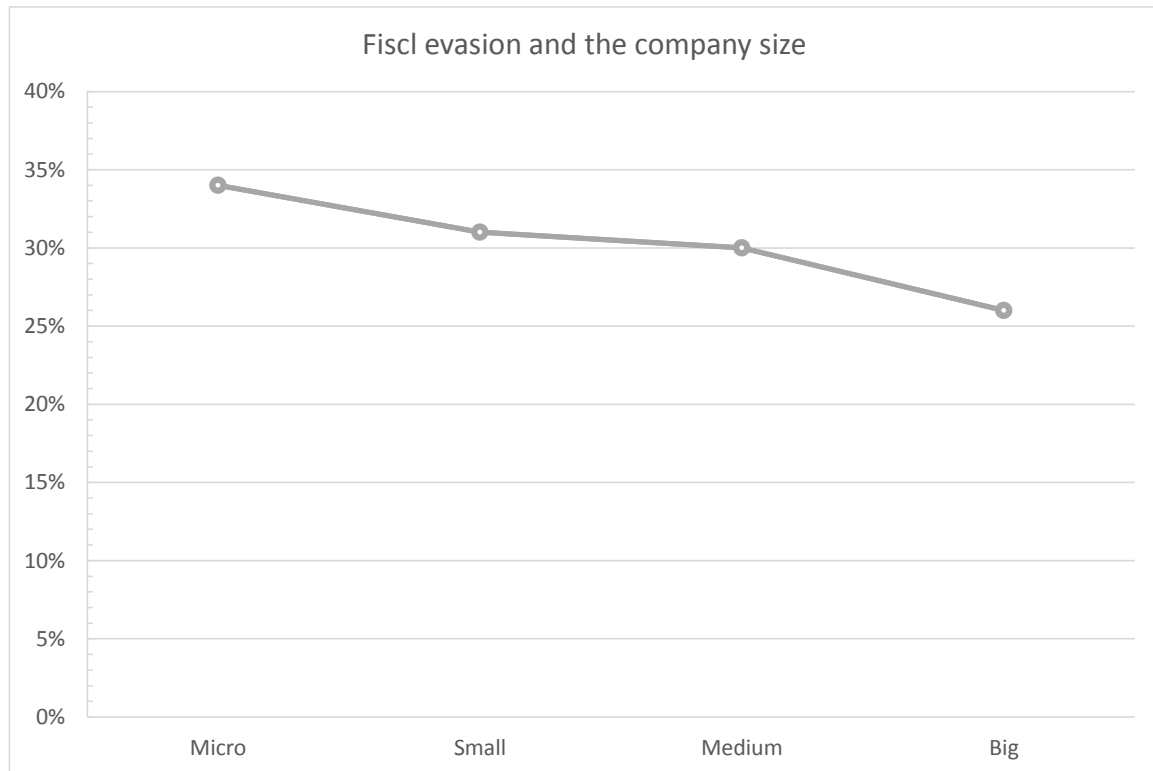
Surveyed businesses were required to provide only one response about the percentage of the annual reported sales on tax authorities. The response gives a tax compliance rate that after deduction from 100%, takes us to perceived level of tax evasion. Average values of all responses provide the overall level of tax evasion in the country. Based on the data of the study, surveyed businesses affirm that on average, businesses in their industry report 69% of their annual sales to the tax authorities, **which indicates that 31% of sales are evaded.**

A further disaggregation of tax evasion according to the firm size shows that there is an inverse relationship between the firm size and the level of evasion. According to Figure No.9,

¹⁷National Business Forum, *Implementation Gaps in Tax Inspections of Private Businesses in Albania, 2014*. The Study can be found here: http://www.nbf.al/images/Implementation_Gaps_in_Tax_Inspections_of_Private_Businesses_in_Albania.pdf

smaller firms tend to show a greater evasion and vice versa, with the increase of firm size (the categorization is based on the number of employees) there is a decrease in the level of tax evasion.

Figure 9. Unreported Sales in the Tax Authorities (Categorized by Business Size)



Source: Authors' calculations based on the survey

A further disaggregation of tax evasion based on sectors shows that higher levels of tax evasion are in the sectors of: agriculture, industry and construction (34% each), although it should be emphasized that the difference of evasion by sector is relatively low. Estimation was required regarding the average annual expenditure increased artificially in front of tax authorities. **Surveyed businesses estimate that on average businesses increase artificially their expenses with an average value of 33%.**

3.6. Labor Informality

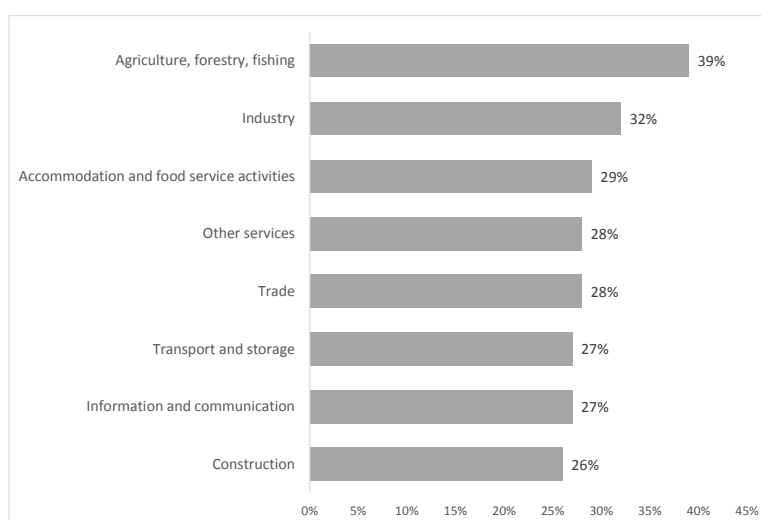
Following the data analysis related to tax evasion, the second focus of this study is the labor informality. This study aims to give an assessment about undeclared / under declared labor of companies that are registered. As explained in the previous chapters, in focus of the study are only registered businesses. To understand the level of labor informality in Albania, within firms that are registered, we have compiled two sets of questions. The first group (2 questions) includes indirect questions where the businesses are asked about the sector in which they operate and the second group (2 questions) includes direct questions about their business.

Respondents were asked to give a single answer in the form of percentage of the labor force that is reported to tax authorities. The responses show the average percentage of declared employees, which discounted from 100%, gives us the level of labor informality. Surveyed businesses believe that in their respective sectors are reported about 71% of their employees to tax authorities. **This means that approximately 29% of the total labor force is not reported.** When businesses were asked directly about the number of workers reported to the tax authorities, it was estimated that 86% of the labor force is declared. Thus, only 14% of the workforce is not declared to tax authorities. This question was considered as very sensitive for the businesses and in most cases they have given an answer of 100% of the total (or expressed by the term “All”). The survey was conducted in August-September 2015. In September the government launched the action on informality and the majority of businesses felt intimidated by the interviewees. This may have influenced the above outcome.

Disaggregated according to the main economic sectors, agriculture has the highest level of non-declaration compared to the other sectors. Average values are given below in figure no.10.

The fact that a relatively high number (29%) of the labor force is not registered creates a very severe burden for these informal workers. Unregistered workers can't blame the company if they are badly treated by the employer, because legally they are not employees of the company. On the other hand, unregistered workers don't make contributions for their retirement; hence they become a burden for future generations. Moreover, employees in the informal sector are paid less than the ones who work formally.

Figure 10. Average percentage of the total labor force not reported to the tax authorities (unregistered)



Source: Authors calculations based on the survey

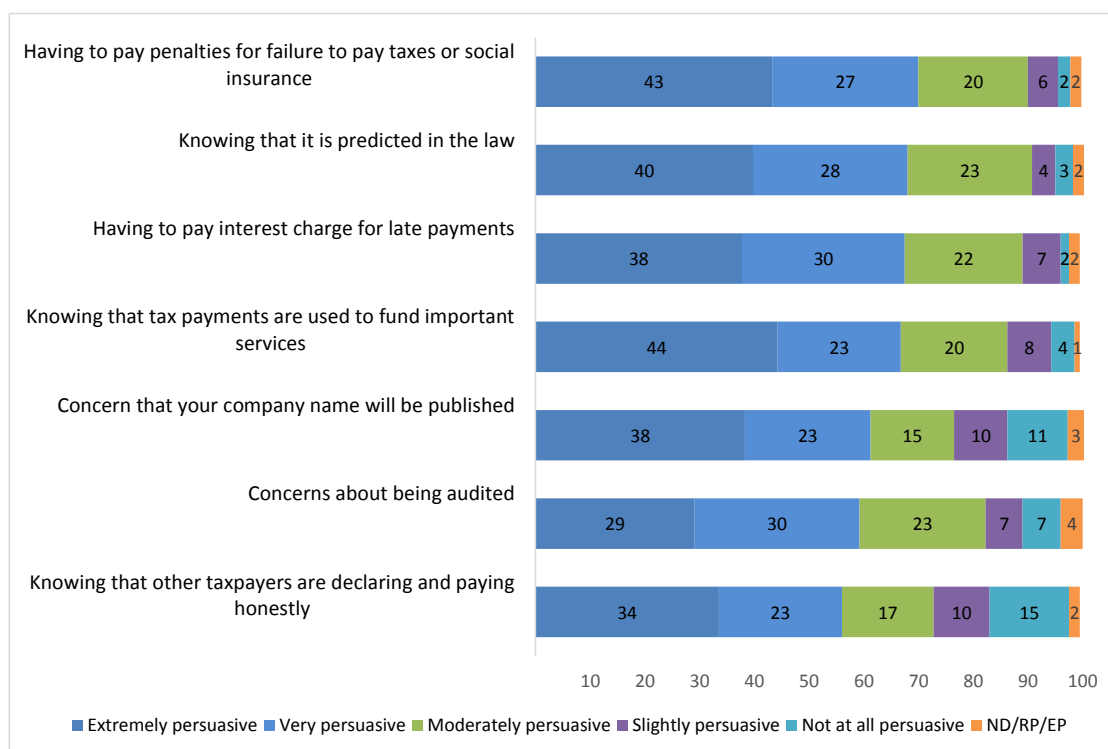
On the second group of questions, in regards to the proportion of wages that are not declared formally to the tax authorities, in companies of their sector, they estimate that on average 57% of total wages are paid through the bank, thus that are declared to the tax authorities and the remainder 43% is paid in cash. This means that this part is not declared to the tax authorities. **Therefore the level of wages that “avoid” taxes, according to the survey, results to be 43%.** When asked directly about their company, concerning the percentage of employees' salaries which are paid through bank transactions, it appears that the average value is 73%. Given that, the average of undeclared salaries is estimated to be around 27%. This is another form of the manifestation of informality in regards to employees (under

declaration). To be mentioned is that when salaries are paid through the bank, it is mandatory to declare taxes of employees and thus to declare it for tax purposes. Another interesting point that emerged from the study is that 54% of businesses stated that they were asked by their employees to be paid in cash and not through bank. This is supported by the above outcome that 57% of wages passed through bank transactions.

3.7. Governmental Policies / Incentives for Formalization Encouragement

An interesting approach used in our study is related to the justification of tax evasion, by listing several incentives from the government and by assessing the impact that they would have in reducing evasion (partially / fully). The results of the study show that the main factors that force businesses to fully pay taxes, are listed in Figure No. 11. The majority of businesses (70%) consider that having to pay penalties in case they do not pay taxes in the due time- as a result of tax inspection - is a factor that encourages them to pay in time. Another important factor that could encourage the formal full payment of taxes is to know that tax payments are used to fund important public services (67 %).

Figure 11. Evaluation of the incentives available to the government of Albania to encourage full payment of taxes

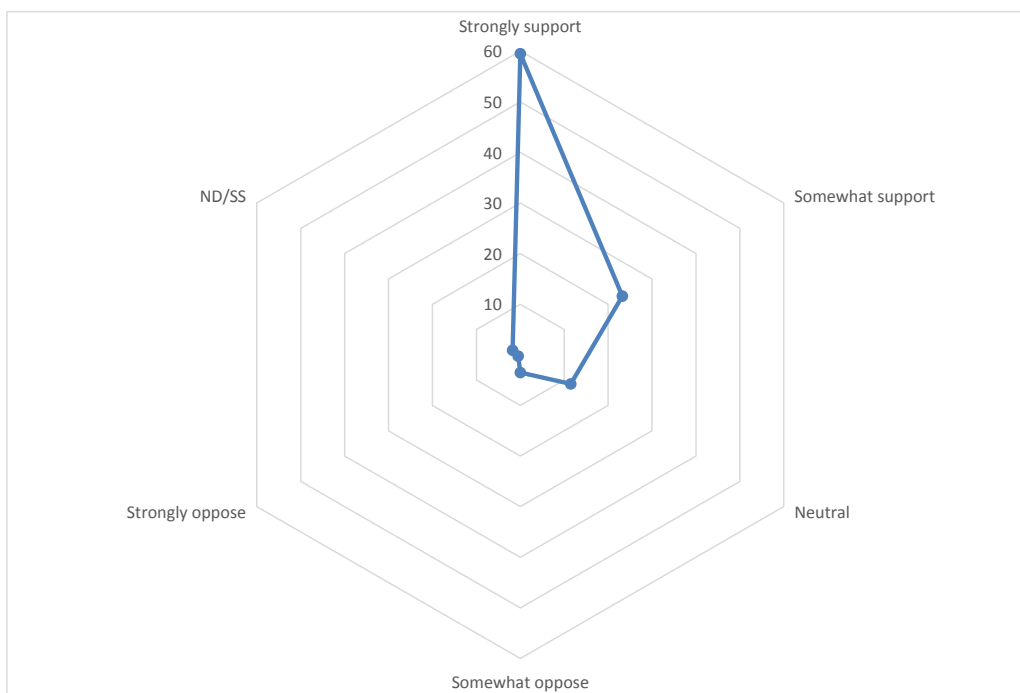


Source: Authors calculations based on the survey

As previously stated, the high level of taxation was cited among business challenges. Between 2008- 2014, Albania applied the flat tax system. Previously Albania applied the progressive tax. On 28 December 2013, following the proposal of the Council of Ministers, the Albanian Parliament approved the 2014 fiscal package amending the main taxes in Albania, thus moving from the flat tax system, to the progressive one. The business

community has continuously expressed through their representatives (associations and chambers of commerce) the dissatisfaction over the new fiscal package which has led to an increase in the level of informality. Thus, the business community and economic experts have concluded that the tax increase has had a direct impact on the growth of the informality level. Businesses were asked if they would favor a tax holiday and a moratorium on fines and penalties for those companies which become registered and report their true income and expenses fully. The results of the survey show that **60% of surveyed businesses strongly support tax decrease and an extension of the timeline for fine payments**, in order to reduce informality. This is as well shown graphically in Figure no. 12.

Figure 12. Do you favor a tax holiday and a moratorium on fines and penalties for those companies which become registered and report their true income and expenses fully?



Source: Authors calculations based on the survey

IV. KEY FINDINGS AND RESULTS OF THE STUDY

This study aims to analyze the informality situation in Albania, focusing on three main aspects: the non-declaration of employees to the tax authorities, under declaration of employees' salaries to the tax authorities, and under declaration of sales / annual income to the tax authorities. In this respect the study aims to identify the main factors that encourage these aspects of informality and make recommendations to improve public policies that lead to reducing informality, improving the business climate in the country, and on this basis the increase of the revenue collection in the state budget. Some key findings of the study are presented as follows:

1. When asked on the **participation and activism in business organizations / associations**, a few more than 1/5 (22%) of the representatives of enterprises included in the survey state that they are members of at least one association in the specific sector of their operations. This means that more than 3/4 (76%) of businesses in Albania operate without being involved in organizations known as interest groups, consequently they are not represented or/and underrepresented due to lack of membership in business organizations. This low involvement rate of local businesses in official business organizations / associations is an evidence of the low level of communication, dialogue and interaction with the government, as well as of the limited opportunities for consultations, capacity of the business community to take initiatives of common interest of this community;
2. The data analysis of the survey shows that two of the **main problems** for the biggest part of the Albanian business community are: " The high level of taxes " to 2/3 of surveyed enterprises representatives (66%), and "(Unfair) Competition from other unregistered businesses ", for nearly 2/3 of them, (64%).¹⁸ Similar conclusions have been confirmed by many other reports and studies carried out by different agencies or / and local and foreign business organizations in Albania;
3. According to the survey results, the majority of interviewed business representatives admitted that **working with the tax administration** constitutes: "Additional financial costs for business", that continues to be a severe/large burden for them. About 3/5 of surveyed businesses representatives admit that "the lack of consistency and constant changes to tax legislation"¹⁹ and "the level of penalties for tax violations"²⁰ constitute a

¹⁸According to the World Bank Doing Business Report, on the social contribution paid from the employer (entrepreneur) Albania has one of the highest levels in the region, but in the same time the lowest fiscal performance, which brings suspicions that there is tax evasion related to this tax. (<http://www.lapsi.al/lajme/2015/11/23/shqipëria-vendi-i-taksave-të-larta-tvsh-dhe-tatim-fitimi-më-të-lartët-në-rajon#.VIV3AITBL&u>)

¹⁹ For example in 2015 (until the 25.11.2015) there were made 15 legal amendments in the fiscal legislation.

²⁰ Meanwhile, in the time of the preparation of this report, the Parliament of Albania decided on large penalties which exceed multiple times the annual earnings, and in some cases, even the assets value of the company, for employees' non declaration, for covering the real profit, and for not providing the customer with a tax receipts. The issue is expected to be sued in the Constitutional Court of the country by the Chamber of Commerce and Industry of Tirana.

severe/great burden for their business and that is accepted by half (1/2) of the enterprises included in the study;

4. Enterprises included in the study estimate that the three **main barriers that prevent informal businesses formalization** are: "Obligations to pay taxes " - for more than 3/4 of them (77%); "Greater risk to be inspected by tax control " - for about 2/3 of them (62%) and "Greater risk of visits by the Labor Inspectorate " - for almost 2/3 of them (57%). From these data it is noted that the business community is not informed enough by the government about its interventions for reducing the informal sector of the economy, that this community is distrustful and suspicious of these measures which are perceived simply as "an effort to ensure higher revenues to the state budget", and that the frequency of tax controls and those of the labor inspectorate have created a situation of tension between the government and the business community, especially during the period September-October 2015. ²¹
5. With regard to **informal practices and frequency of occurrence** in the sectors in which enterprises operate, the survey showed that: "Private businesses employees are paid in cash (cash)" - in 2/3 of the cases (66%); "Private businesses employ a worker without a contract " - in almost 2/3 of the cases (63%) and "Private businesses report lower values than the real annual turnover" - in about 2/3 of cases (61%). This means that among the interviewed registered businesses on some informal practices and frequency of occurrence in the sectors in which the companies operate, the biggest part admit that the above practices regarding informality happen "always / often" in the sector of their business activity.
6. Asked on the **main reasons that prevent businesses from operating in full transparency**, interviewed business representatives have listed three main obstacles: "The high level of taxation for businesses with high incomes" - in about 3/4 of the cases (71%); "Corruption among public officials " in about 2/3 of cases (63%) and "Tax Control" in more than half of them (55%);
7. A separate issue is constituted from the questions on which side "initiates" corrupt practices, business or tax administration? Businesses were asked whether "**is it primarily some business owners that try to bribe inspectors in order to obtain unfair advantages or is it primarily corrupt tax inspectors that seek illegal payments**". About half of surveyed businesses admit that both parties are initiators of seeking or giving bribes (47%); About 2/5 of them (38%) declare that " inspectors are the ones who primarily demand bribes from the company to offer facilities in the process of tax control".

These data and information from other sources²² indicate a high degree of involvement with and / or without its will of the business community in corrupt practices (bribery). They also show a low confidence rate from this community to solve problems through regular legal procedures. Likewise they also prove the dangerous mentality created over

²¹ Until October 18, 94,000 inspections were conducted across the country. 831 subjects were found to exercise activity without being registered, while there are thousands and thousands of entities that have registered voluntarily. 5777 subjects were also found not equipped with fiscal cash register, 902 subjects who did not issue a tax receipt and 813 subjects with undeclared workers. *General Directorate of Taxation*

²² EBRD 2015, *Business Environment and Enterprise Performance Survey (BEEPS) (2013)*.

the years that through the use of bribes, gifts, etc., to tax inspectors, the calculated/defined obligations in a tax control report can decrease drastically;

8. In relation to the **reporting rate of sales from businesses**, according to the survey data, results that: **Businesses report on average a little more than 2/3 of their annual sales to the tax authorities (69%)**, which means that about 1/3 of the relevant fiscal obligations on sales are evaded (31%). In other words, currently around 1/3 of the Albanian economy is not subject of fiscal obligations as stipulated by the law. When asked about the main reasons of not being fully transparent, the surveyed businesses stated that the main three reasons are high taxes (71 %), corruption (63 %) and tax inspections (55 %).
9. A separate aspect is the analysis of **the reporting rate of the ensured employees** with social security. Surveyed enterprises representatives believe that in their respective sectors more than 2/3 of their employees (71%) are reported to tax authorities. This means that almost one third of the total labor force is not reported to the tax authorities (29%).
10. Regarding the payment method used by businesses, interviewed enterprises representatives claimed that: **Less than 2/3 of transactions for the payment of employee salaries out of the total salaries are paid by bank** - being this way part of the transactions declared to the tax authorities – and are formal. The remaining part (43%) is paid in cash. This means that hat if a salary is paid in cash, it is undeclared, and therefore no social security of health contributions are paid.
11. Representatives of the surveyed enterprises were asked on **factors that may encourage formal full payment of taxes.**

The analysis of data shows that among the factors that can encourage formal full payment of taxes are: “If these tax inflows go to fund important services”, for 2/3 of cases (67%) and “If there would be a reduction in the level of fees paid by businesses and employers”, in approximately 2/3 of cases (60%).

V. RECOMMENDATIONS OF THE NATIONAL BUSINESS FORUM (NBF)

The recommendations presented below are based on research results and consultations among NBF members.

A. TAX BURDEN AND BUSINESSES MOTIVATION TO PAY TAXES

Issue 1: Reduce the tax burden and increase the motivation of businesses to pay taxes

Albanian surveyed businesses have admitted that the main reasons why they don't feel at all motivated to pay taxes are: (a) the high level of taxes; (b) the continuous tax inspections and the bribes they give to inspectors that somehow encourages them to hide profits / income, thus paying less taxes; (c) the lack of qualitative public services that should be received as a result of taxes paid.

Hereof the National Business Forum proposes:

(a) Taking into consideration the reduction of taxes, accompanying this with a sectoral analysis where certain sectors should have a specific tax. Some specific recommendations about taxes that come from the NBF, are presented as below. For the agriculture sector, the NBF proposes a reduction of VAT to 8%, profit tax to 0 %, social insurances to 10 %. For the tourism sector, the NBF proposes a reduction of VAT to 8 %, profit tax to 10%, social insurances to 10 %. For the transport sector, the NBF proposes a reduction of VAT to 0 %, profit tax to 5%, social insurances to 5 %

(b) Design a long-term pact between the government and chambers of commerce / business associations in order to work together on the formalization of the economy, instead of frequent continuous tax inspections of tax administration - working together with businesses stimulating them to become formalized through awareness campaigns, providing consultations to various businesses in need, etc. This might be done using different channels of communicating to citizens about where their money is spent. For instance, the government should publish videos on TV about what happens with the taxes they pay. In addition, street banners might be used on this purpose.

(c) Government should prove to citizens / businesses that their taxes are important and that they go to fund important public services.

Issue 2: Improving transparency and accountability of the tax administration

According to the survey results, businesses acknowledge that there is a lack of a real consultation by the government in the framework of decision making process about the business community. They accept that even when consulted, their inputs are not reflected in the relevant legislation.

Hereof the National Business Forum proposes:

- a) The tax authorities should publish an annual report about their services, at latest the end of March of the following year. Annual reports must be accessible online and should contain key indicators of the administration performance, the number of tax inspections, the number of fines, legal tax packages, cases won / lost, etc.
- b) (i) Each tax legislation must be consulted in real terms with stakeholders (business community and representatives of the community) and all the stakeholders' comments should be published as well;
- (ii) Each revised secondary legislation, should be published at least 30-days before it takes effect, and in cases of not being released, implementation by businesses should be considered invalid.

Issue 3: Increasing the sustainability of tax legislation

According to the study, most businesses recognize that the lack of consistency and continuous changes of tax legislation is not leaving time to businesses to recognize and implement the changes. This is accepted by 53% of surveyed businesses.

Hereof the National Business Forum proposes:

- d) Increasing the stability of tax legislation in order to avoid problems when adapting changes;
- e) Improving the organizational capacity of tax administration employees by conducting training by the Fiscal Academy or informative sections in order to increase the efficiency and effectiveness of their work, thus informing businesses about the legal changes and providing the necessary support to understand the changes made, especially for micro and small businesses.

B. LABOUR COMPLIANCE**Issue 1: Application of the proportionality principle regarding fines imposition in cases of undeclared workers**

The phenomenon of "non-declaration of employees" is very common and is one of the main factors that impact the growth of informality. According to the survey findings, on average, 29% of the total workforce is not reported to tax authorities. The need to reduce this phenomenon has led to the undertaken of tough measures by the government, thus increasing the fine for exceeding the violation committed from business, bringing thus the worsening of the situation. According to recent changes in the law "On tax procedures", small business is fined 500 thousand ALL for the violation of the non-declaration of employee, for which previously had been fined in the amount of 50 thousand ALL.

Hereof the National Business Forum proposes: It is needed the proportionally principle to be taken into consideration when putting penalties about the non-declaration of workers. The level of penalty should be taken as a reference the some months' salary but it should not be the same for all business sizes and categories and just a penalty which indeed does not represent anything except an extreme amount of penalty.

Issue 2: Reviewing the taxation levels on income derived from wages

Another aspect of informality is the under-declaration of employees' salaries. Based on the survey results, the majority of employees require to businesses to be paid in cash and not through the bank, as a result of the high level of taxation. According the survey, the level of wages that avoid taxes results to be 43%.

Hereof the National Business Forum proposes: Reviewing the taxation levels for income derived from wages in order to formalize this component and creating favorable conditions for foreign persons working in Albania, attracting them with a more favorable tax system for paying taxes in Albania.

C. TAX INSPECTION PROBLEMS

Issue 1: Improving the professional and ethical standards of tax inspectors

The majority of surveyed businesses (47%) admit that are both parties that take the initiative to seek or give bribes, while 38% of surveyed businesses claim that tax inspectors ask first for bribes in order to better facilitate the process of tax inspection.

Hereof the National Business Forum proposes: Improving the professional and ethical standards of tax inspectors during the interaction with businesses, considering that the damages that a tax inspector can cause to a business activity are potentially very high.

Issue 2: Reducing the amount of prepaid fines with 10% of the amount of the tax duties (currently 100%)

Another issue of concern by businesses is the "*high level of fines for tax violations*" which is accepted by 50% of surveyed businesses. Also they expressed that most of these fines are imposed in abusive manner and the biggest problem lies in the fact that for appealing these cases, the business is required to pay initially 100% of the fine.

Hereof the National Business Forum recommends: The amount of the prepaid fines to be reduced to 10% of the amount of the tax duties, as provided in the assessment notice.

Issue 3: The selection of taxpayers, subject of tax inspection, should be made only on the basis of risk assessment system.

According to the survey findings, it is evident that the frequent visits of tax inspectors are a very big problem because they prevents the normal progress of business activity - 90% of surveyed businesses had had a tax inspection during the last year. The inspected companies don't know the reason why they were selected for inspection and in the absence of clear criteria the selection is arbitrary.

Hereof the National Business Forum recommends: The selection process should be administered only automatically, according to the integrated computer system data and results, based on the risk assessment analysis. This requires the computerization of all Regional Tax Directorates. Centralized selection system offers more guarantees for the sustainability of the process. In addition, businesses have the right to know the criteria taken into account when assessing risk, so it is recommended the publication of these criteria in order to increase the transparency.

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