Analysis of the Effect of Simplified Profit Tax on SMEs at the Level of Factual Budgeted Revenues in Albania

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Abstract: Small and medium enterprises are very important part of Albanian Economy, they represent almost 99% of Albanian registered enterprises and generate more than 80% of jobs in the labour market. They also contribute 60-75% of Gross Domestic Product. SME-s are key elements of the Albanian economy. This study tries to investigate the effects of changes in fiscal policies to SMEs in Albania, which is also the reason why this topic is of interest to many researchers. If we compare Albania's number of SMEs with other countries that stand for the same level of economic development, they are almost at the same level. Moreover, turnover and the number of employees have increased for SMEs, while revenues collected from this tax have decreased. The study tends to explain how the simplified corporate profit tax rate affects budget revenues, its impact and the changes over the years. We use secondary data to analyze periods from the year 2000 to the year 2019. Also, to analyze if the simplified profit tax is important or statistically significant and it has an effect on the budget revenues, we use an econometric regression model. In a conclusion, this study will also show the government measures during the post-Covid-19 period taken for SMEs. Besides conclusions, we give our recommendations based on our econometric model analysis.

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1 Introduction

Small and medium-sized enterprises (SMEs) play an important role in the future growth of Europe and can be found in many countries around the world. [6] In countries with growing economies and transitions, including the Albanian economy here, SMEs play a truly significant role. Small and medium-sized enterprises in transition countries arose because of privatization and the demise of large state-owned enterprises and because of several new ones, mostly very small enterprises that arose as a result of market liberalization. [27] Small and medium-sized enterprises represent 99% of Albanian registered enterprises and create more than 80% of jobs in the labor market. They also contribute 60-75% to the gross domestic product. Their main role is that SMEs reduce unemployment and create new jobs. Given the huge growth of the SME sector in the region, the lack of a real culture of voluntary compliance and weak tax administration capabilities, simplified taxation is an important strategy to address the challenges of the growing informal economy.[9] In Albania, during the transition period of the year, various measures were taken by the government regarding the performance of small and medium-sized enterprises. These non-aligned actions led to inefficiencies. There are several unsuccessful legislative and institutional reforms for SMEs that have not contributed to the development and improvement of the business environment. Some of them are as follows: facilitation of business registration, permits and licenses, regulatory impact assessment / RIA, ICT support, Free Trade Agreement, CEFTA, provision of financial instruments, training, growth of electronic communications, etc. Albania has also applied all the principles of the Small Business Administration (SBA) [1]. This is one of the most important agreements in the agenda of the European Commission for the development of small and medium-sized enterprises, not only for EU member states, but also for the countries of the Western Balkans, currently applied in Albania.[10]

The Albanian government applied two different fiscal regimes in 2009–2019. The first falls into the years 2009-2014 and the second falls into the years 2014-2019, which are represented by different political directions. Regarding the first policy direction, in the 1st fiscal period there is a flat tax of 10% until 2014. The aim was to increase the tax base to achieve the target of increasing tax revenue. This would be achieved if the economy had greater investment capacity, higher consumption, and income.

In 2014, with a change in political direction, the fiscal policy brought the ideology of fair taxation by increasing the tax burden to 15% for profit tax, dividend, and income tax. Meanwhile, the simplified profit tax for small and medium-sized enterprises was replaced by an increased tax that was applied during this period. During the mentioned period, there was also a change in the definition of small and medium-sized enterprises. They were first classified based on the criteria of the Albanian government. After 2014, they were classified based on EU principles. Despite the frequent fiscal variability that indicates the achievement of precise results for each study conducted in the mentioned period, this study highlights how the simplified rate of tax on the profit of small and medium enterprises affects the actual budget revenues. What impact does this tax have on local and council tax revenue? in 2019, according to the annual report of local finances issued by Coplan and the Ministry of Finance, the revenue collected from the simplified profit tax for small businesses was ALL 376.3 million, an increase of ALL 46.8 million compared to 2018. [2]. The share of these revenues in total local tax revenues is 2.4%. 1.5% is involved in revenues from municipal resources. With respect to the study period, shown in the figure below, the revenue collected from the simplified SME profit tax decreased [11]. This is the reason that drives the study, and it is important to analyze whether the tax rate of the simplified SME profit tax affects the income, in other words, whether it is significant or not. This connection and importance are demonstrated through an econometric model. Ultimately, SMEs, along with other taxpayers, benefit from a well-functioning tax administration system.   [29]
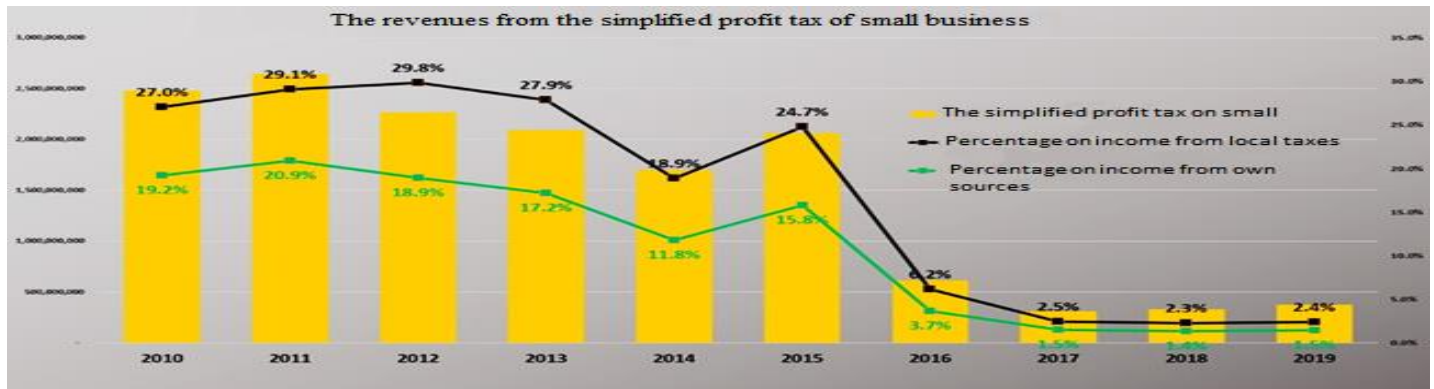
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Fig.1: The revenues from the simplified profit tax of small business
Source: INSTAT, 2022

According to the fiscal issues research center ALTAX, the simplified profit tax for SMEs is 0.02% of GDP in 2019 and has not changed in the previous three years [12]. From 2007 to 2012, the simplified profit tax was 0.2% of GDP; from 2013 to 2015, it was reduced to 0.1% of GDP; and from 2016 to 2017, it was reduced to 0.04% of GDP. [13] As shown in the table below, the Simplified Profit Tax is variable during the period of the study

Table 1. Data of the analysis

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Tax revenue	20.8	20.3	21.1	21.5	22.5	22.9	23.5	23.6	24.5	23.7	23.3	23.4	22.6	22.2	24.1	23.9	25.1	25.7	25.7	25.2
From taxes and customs	16.2	15.6	16.1	16.1	16.7	16.9	17.8	18.3	19	18.3	18	18.1	17.5	17	18.2	18	18.7	18.9	18.7	18
Income from special funds	4	4	4.2	4.2	4.5	4.5	4.5	4.3	4.4	4.4	4.3	4.4	4.3	4.4	5	5	5.4	5.6	5.7	5.8
Revenues from local government	0.6	0.7	0.9	1.2	1.3	1.5	1.3	1	1	1.1	1	0.9	0.8	0.8	0.9	0.8	1	1.2	1.3	1.4
Local tax	0.3	0.4	0.4	0.7	0.8	1	1	0.7	0.7	0.7	0.6	0.6	0.5	0.5	0.5	0.4	0.7	0.9	1	1
Property tax (building)									0.1	0.1	0.2	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Simplified profit tax of small business	0.3	0.4	0.4	0.4	0.6	0.5	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.04	0.02	0.02	0.02

2 Literature Review

In this chapter, will be explained three main issues of the study. The first part of the literature explains the meaning of SMEs, the second part explains their importance in economy and the third part explains their performance over the years 2018 and 2019.

1. Definition of SMEs:

Small and Medium Enterprises (SMEs) are recognized all over the world as backbone of modern economies because they make major contributions to global economic growth and sustainable development through employment generation, poverty alleviation, wealth creation and food security [25]. SMEs play a major role in economic growth in the OECD area, providing the source for newest jobs [23]. Moreover, SMEs are effective tools for poverty alleviation. [28] They represent about 90% of businesses and more than 50% of employment worldwide [24]. The definition of

SMEs varies from country to country. SMEs are defined as non-subsidiary, independent firms, which employ fewer than a given number of employees. This number varies across national statistical systems [22]. Most SME jobs are in the service sector, which now accounts for two-thirds of economic activity and employment in OECD countries. Based on various studies, for example, based on OECD publications, the best practice policies for SMEs include financing, business environment, technology, management capabilities and access to markets.

SMEs are enterprises that have income, assets or the number of employees below a certain threshold. The main criteria for classifying them by size used by many countries are: number of employees, turnover and / or value of assets [5]. Until 2014, Albania

applied its own criteria for the classification of SMEs, since that the Albanian economy in terms of size is very small compared to other EU countries.

According to this economic definition, are considered as small enterprises the economic enterprises which met the three following criteria:

1. They own a relatively small part of their market
2. They are managed by the owners themselves and not through a formal management structure
3. They are not part of a big business, they are independent,

On the other hand, Law no.8957, dated 17.10.2002, "On small and medium enterprises" used the following classification [19]:

1. Micro enterprices, with up to 5 employees
2. Small enterprises, with 6 to 20 employees
3. Medium enterprises, with 21 to 80 employees.

The European Commission, to solve the problem of defining small and medium-sized enterprises, took the initiative to unify a single definition at EU level. After almost a decade it became necessary to revise this definition of the European Commission and so in 2005, a new definition for SMEs was adopted [7].

An enterprise is an entity engaged in an economic activity regardless of its legal form. This definition has been given in advance by the European Court of Justice. So, it is the economic activity, the determining factor and not the legal form of business [3].

The new EU definition adopted in 2005 considers the three following criteria: 1) number of employees, 2) annual turnover, and 3) annual balance sheet. Based on these three criteria, enterprises are divided into 3 categories, with the following characteristics [14]:

Table 2. European Commission Classification of SMEs

Category	No. of employees	Annual turnover	Annual balance sheet
Medium	<250	<€ 50 million (in 1996: € 40 million)	<€ 43 million (in 1996: €27 million)
Small	<50	≤€ 10 million (in 1996, € 7 million)	≤ € 10 million (in 1996: €5 million)
Micro	<10	≤ € 2 million (wasn't previously defined)	≤ € 2 million (wasn't previously defined)

Source: European Commission Recommendation of 6 May 2003 on the definition of micro, small and medium-sized enterprises.

So the EU and a large number of OECD countries, transition and developing countries have set the maximum limit of number of employees for SMEs at 200-250, with a few exceptions: such as Japan (leading up to 300 employees) and in the US (500 employees).

Currently in Albania, the simplified Profit Tax for SMEs is determined on the basis of annual turnover. Enterprises that have an annual turnover of up to 5 million ALL, the tax is zero. For enterprises with a turnover of 5 to 14 million ALL per year, which are also considered small enterprises, this tax is 5% and for enterprises with a turnover over 14 million ALL per year, which are considered medium and large, the profit tax is 15%.

2.   SMEs importance in economy:

The role of small and medium enterprises is worldwide acknowledged for their unique contribution to the economic development. (SAVLOVSCHI. L, ROBU. N, 2011) Various researches show that there is a positive correlation between SME development and economic growth [20]. SMEs are vital actors for enhancing innovation, competitiveness, entrepreneurship and the establishment of an effective innovation system for developing countries [17]. An important involvement of the external impact of small and medium enterprises is the fact that their contribution in the development is not limited to the sector of SMEs of the economy, but more than that, it is extended as impact on the enterprises not in this sector, with significant influences [26].

The fact that the role of SMEs in an economy appears to increase with country income level might indicate that SMEs are themselves a driver of economic growth [14]. In developing countries, small and medium enterprises (SMEs) account for more than half of all formal employment. [15] The SME sector's contribution to GDP also confirms its economic importance. Countries with a higher level of GDP per capita have larger SME sectors in terms of their contribution to total employment and GDP [4].

There is considerable interest in SMEs in developing countries. There are probably two main reasons for this. One is the belief that SME development may prove to be an effective antipoverty program. The second is the belief that SME development is one of the building blocks of innovation and sustainable growth [17].

In particular, SMEs:

-boosting competition;

-Has the flexibility to respond to rapidly changing demand;

-Provide mostly employment, including in times of crisis;

-Enables self-realization of citizens;

-Creates conditions for the formation of the middle class that provides stability in society [18].

3 SMEs Performance for the year 2018 to 2019

SMEs have to improve and develop their performance to survive and achieve their goals and objectives. The main argument is that SMEs require a performance measurement system specifically designed and tailored to their characteristics and needs [16]. However, despite the flurry of research on SMEs' performance, there is no consensus on the factors that drive SME's performance [21]. According to the latest data from the Institute of Statistics [13], by the end of 2019, the number of active SMEs was 162,342, almost the same as in 2018. Their main activity is trade and enterprises in this sector occupy 23.0% of enterprises registered in 2019, compared to 23.2% registered in 2018. While small enterprises as a result of fierce competition that the trade chains are creating more and more, as well as the weak consumption of the economy, are in great difficulty. According to INSTAT[1] 2019, the number of small enterprises with 1-4 employees, excluding the agriculture sector was 116.6 thousand in 2019 marking a decrease of 2.5% due to the closure of about 4 thousand enterprises.

The trade and industry sectors had the largest contraction in business. In the trade sector, this decline has been with 2300 businesses and continues to decline. The same can be said for the industry sector, where there was a decrease of 2000 thousand less active businesses, compared to 2018 as a result of closing their activity and 600 new businesses less compared to 2018. While the construction sector, telecommunications and other services have grown. To reduce the negative effects of "Covid 19", the government has implemented two financial rescue

packages focusing on employees and the self-employed in small enterprises. The government has also approved packages that guarantee business support funds, which helped but didn't solve the whole business problem. The International Monetary Fund (IMF) has estimated that Albania's direct and indirect support packages were equal to 2.9% of GDP, from 5.8% for the Western Balkans average, due to the high public debt which reached 79.9%. Also, there has been a reduction to -23.8% of the simplified profit tax on small businesses during the period 2015-2019. This income created from the simplified profit tax for small businesses according to the law "On local taxes" goes to municipalities budget. The government through the tax administration collects this tax which is allocated to 98% of the municipal budget while only 2% goes to the government budget. Following the measures taken, the current government issued the decision that starting from 2021 to 2029 will remove the profit tax for entities with an annual turnover of up to 14 million ALL per year, for SMEs which were most affected by the pandemic. According to General Directorate of Taxes data, there are 91 thousand enterprises with turnover from 0 to 14 million ALL per year in the whole country, 80% of which or 72,800 businesses declare less than 5 million ALL annual turnover. Only a difference of 18,200 enterprises is in the category with annual turnover between 5-14 million ALL, who pay a simplified profit tax of 5%. So is the number of businesses that benefit from the prime minister's promise. According to the ALTAX study center, this decision does not violate the law, but, "It is not a good thing, as long as it does not reconcile with all factors." [8]. Experts estimate that the head of government is promising the abolition of a tax that actually belongs to the local government, while no alternative is given as to how the municipal budget will compensate for this missing revenue.

Hypothesis(H1): The simplified[2] Profit Tax Rate on SMEs affects the level of tax revenues.
Hypothesis(H0): The simplified Profit Tax Rate on SMEs dose not affects the level of tax revenues.

4 Methodology
- Importance of the study:

First, the question under consideration is obviously clear because there is a logical relation among the factors. In this connection, we have considered as an independent variable the profit tax rate, while as a dependent variable the factual budget revenues from this tax

- Definition of variables:

Based on available data for this analysis, in support of the hypothesis, it is appropriate to utilize the logistic regression (single-factorial linear model). This model can be described by the equation: $Y=a+bX1+e$. Y is a dependent variable and X is the independent variable.

- Data:

In our study we have used secondary data which have widely contributed to the analysis presented here. The sources of data include reports, bulletins and various studies.

- Method Used:

The econometric model is based on single-factorial linear model. Using the INSTAT and ALTAX data, the statistical analysis on the relationships and impact among factors will be carried out.

Whether this model is of importance or not will be established by the comparison of the factual

fisher (Ff) with critical fisher (Fk) that are calculated by the following formulas:

$$\mathbf{Ff} = \mathbf{R}^2/(\mathbf{k-1}) \ / \ (\mathbf{1-R}^2) \ /(\mathbf{n-k})$$

$$\mathbf{Fk} = \boldsymbol{\alpha}; (\mathbf{K-1}); (\mathbf{n-k})$$

α is the percentage of error that has the values: 1%, 5% and 10%.

K is the number of parameters in the model. n is amount of data under consideration.

R^2 is coefficient of determination. It indicates what percentage of dependent variable is determined from independent variable and is given by the formula:

$$\mathbf{R}^2 = \mathbf{SHKR}/\mathbf{SHKP}$$

SHKR and SHKP are calculated by these formulae:

$$\mathbf{SHKP} = \sum (\mathbf{Y} - \mathbf{\bar{Y}})^2$$

$$\mathbf{SHKR} = \sum (\mathbf{Y} - \mathbf{\bar{Y}})^2$$

where $\mathbf{Y} = \mathbf{a} + \mathbf{bX}$

$\bar{Y}$ is the average of dependent variable data.

Factual fisher can be determined by formula: $\mathbf{Ff} = \mathbf{SHKR} \ / \ (\mathbf{k-1}) \diagup \mathbf{SHKM} / \ (\mathbf{n-k})$

If Ff > Fk the model is statistically significant and alternative hypothesis (H1) is accepted.

If Ff < Fk the model does not show statistical significance and the prime hypothesis (H0) is accepted.

5 Results and Interpretation of Regression Analysis:

Model 1: OLS, using observations 2000-2019 (T = 20)
Dependent variable: **Tax Revenues**

	Coefficient	Std. Error	t-ratio	p-value	
Const	24.8006	0.428400	57.89	<0.0001	***
Simplified Profit Tax Rate	−6.75844	1.54244	−4.382	0.0004	***

Mean dependent var	23.28000	S.D. dependent var	1.571657
Sum squared resid	22.70976	S.E. of regression	1.123233
R-squared	0.516114	Adjusted R-squared	0.489231
F(1, 18)	19.19881	P-value(F)	0.000360
Log-likelihood	−29.64939	Akaike criterion	63.29879
Schwarz criterion	65.29025	Hannan-Quinn	63.68754
Rho	0.573978	Durbin-Watson	0.682473

Tax Revenues = 24.8 - 6.758 Simplified Profit Tax Rate
R^2=0.51=51%
P-value <0.05
P-value(F) <0.05

Inteterpretation 1: With a 1-unit increase in the simplified profit tax rate, tax revenues will be lowered by 6.16 units.

Heteroskedasticity test: H0: Heteros missing ; **H1:** Heteros not missing

White's test for heteroskedasticity
OLS, using observations 2000-2019 (T = 20)
Dependent variable: uhat^2
coefficient std. error t-ratio p-value
-- --
const   0.805653   0.647030   1.245   0.2300
simplified tax rate ~   −1.78864   5.54218   −0.3227 0.7508
sq_ simplified tax rate ~   9.49284   9.62046   0.9867 0.3376
Unadjusted R-squared = 0.229771

Inteterpretation 2: R^2=51%, shows that 51% of the change in tax revenue depends on simplified tax rate.

Inteterpretation 3: The factual Fisher is larger than the critical fisher. This shows that the model is signifiant or statistically important.

Test statistic: TR^2 = 4.595419,
with p-value = P(Chi-square (2) > 4.595419) = 0.100489

Interpretation: Prob=0.10 greater than 0.05, H0 stands.

NORMALITY test:

H0: Normal distribution; **H1:** Abnormal distribution

Frequency distribution for residual, obs 1-20
number of bins = 7, mean = 4.26326e-015, sd = 1.12323
interval   midpt   frequency rel.   cum.
< -1.6625   -1.9731   3 15.00%   15.00% *****

```
   -1.6625 - -1.0412   -1.3519        0
0.00%   15.00%

   -1.0412 - -0.41998  -0.73061       3
15.00%   30.00% *****

  -0.41998 -  0.20128  -0.10935       5
25.00%   55.00% *********

   0.20128 -  0.82253   0.51190       4
20.00%   75.00% *******

   0.82253 -  1.4438    1.1332        3
15.00%   90.00% *****

        >=  1.4438      1.7544        2
10.00%  100.00% ***


Test for null hypothesis of normal
distribution:
Chi-square(2) = 1.078 with p-value 0.58334
```

Interpretation: Prob=0.58 with a large than 0.05 H0 stands, the time series has normal distribution

	2010	2011	2012	2013	2014	2015	2016	2017	2018
TOTAL INCOME	**324,721**	**330,469**	**330,384**	**327,178**	**366,721**	**379,206**	**407,021**	**430,397**	**449,465**
Monetary assistance	**4,605**	**3,811**	**5,559**	**5,737**	**10,186**	**11,215**	**14,639**	**11,085**	**8,133**
of which: budget support from CE							3,562	2,738	2,251
Tax revenue	**288,564**	**303,927**	**300,862**	**299,888**	**335,868**	**342,308**	**369,884**	**398,629**	**419,334**
From taxes and customs	**223,019**	**235,509**	**232,591**	**229,031**	**253,413**	**258,882**	**275,780**	**293,386**	**304,318**
Value added tax	113,998	119,189	116,533	111,940	123,730	125,783	131,390	139,541	143,464
Profit tax	17,606	19,712	16,853	15,119	28,852	24,968	29,151	31,645	34,461
Axcise	38,788	40,403	36,421	38,151	32,606	39,027	41,896	45,105	44,987
Personal income tax	27,058	27,967	27,989	29,570	21,479	29,661	31,412	32,102	36,517
National taxes and other	18,295	21,388	28,677	28,454	40,894	33,647	35,794	38,502	38,673
Customs tax	7,274	6,850	6,118	5,797	5,852	5,796	6,137	6,492	6,217
Revenues from local government	**11,898**	**11,791**	**10,859**	**10,825**	**12,447**	**11,700**	**14,951**	**18,447**	**21,863**
Local tax	7,684	7,279	6,210	6,396	7,060	5,746	9,675	13,273	16,354
Property tax (buildings)	1,896	1,942	2,506	2,454	3,678	3,921	4,678	4,879	5,192
Simplified profit tax of small business	2,318	2,570	2,143	1,975	1,709	2,033	598	296	316

Simplified profit tax rate 2010-2021

Year	Enterprises by annual income (All)	Rate
2010	Flat tax	10%
2011	Flat tax	10%
2012	Flat tax	10%
2013	Flat tax	10%
2014	0 - 2 million	All 25,000
	2 - 8 million	7.5%
2015	0 - 2 million	All 25,000
	2 - 8 million	7.5%
2016	0 -5 million	0%
	5 - 8 million	5%
2017	0 -5 million	0%
	5 - 8 million	5%
2018	0 -5 million	0%
	5 - 8 million	5%
2019	0 - 14 million	5%
2020	0 - 14 million	5%
2021	0 - 14 million	0%

6 Conclusion

1. In developing nations such as Albania, SMEs have a significant impact on economic growth and employment; they also generate more than 80% of jobs and contribute 60-75% of GDP.

2. Albania has backed all the major small business acts (SBA). This is one of the most important accords on the European Commission's agenda for the development of SMEs, not only for the EU Member States but also for Western Balkan countries, with Albania having previously implemented it.

3. The money received from the simplified profit tax on small businesses was 376.3 million ALL in 2019, according to the Annual Report of Local Finance released by Coplan and the Ministry of Finance. These revenues account for 2.4% of overall local tax receipts, and they provide 1.5% of municipal revenue streams. The revenues received from the simplified profit tax on small and medium firms have declined over the study period of 2009-2019.

4. During the time period studied, the simplified profit tax rate for SMEs was variable and not a long-term fiscal policy, resulting in a decrease in revenue collected from this rate.

5. Through our econometric model, we confirmed the hypothesis that the tax rate of the simplified profit tax has a strong negative correlation with the factual budget revenues collected from this tax. With a 1-unit increase in the simplified profit tax rate, tax revenues will be lowered by 6.16 unit.

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