*Jean Tesche**

Direct Taxation in Southeastern Europe

This paper gives an overview of the current situation and trends in direct taxation in Southeastern Europe (SEE). Here, SEE refers to the countries of the former Yugoslavia plus Albania, Bulgaria and Romania. Some data on the Czech Republic, Hungary, Poland and Slovakia is also included for comparison. Although all of the countries of SEE had some form of socialist government, there were three distinct types: Albanian, Soviet and Yugoslav.

The countries that emerged from the former Yugoslavia started with the same system. Clearly some have changed more than others. Slovenia, with by far the highest standard of living (Table 1), has now joined the European Union as will Bulgaria and Romania soon. EU membership is a real possibility for the other countries in the region as well and all are moving towards modern European tax systems.

The EU does not require the same level of uniformity in direct taxes as it does for indirect taxes. There have been several attempts by the EC Commission to harmonize direct taxation, but so far the main agreement has been a minimum level of taxation for savings (European Commission, 2000). The desire of all these countries to join the EU means that they are ready to adapt their tax systems more quickly than might otherwise be the case.

Section One will give a bit of background of the region, particularly of the former Yugoslav countries. Section Two will discuss the current direct tax systems and recent changes. Section Three will give some thoughts on the future development.

1. Background

Much has changed in the region since the mostly peaceful falling apart of the Soviet Union's sphere of influence and the violent breakup of Yugoslavia. In socialist systems, taxes were more of a residual resulting from government decisions as to production, wages and prices than an explicit policy. Albania had a more extreme form of this before 1990, with state control of virtually all of the economy. In all three types of systems, any taxes on wages were invisible to wage earners, who received the net amount.

Yugoslavia started the period of transition from Socialist systems towards the end of the 1980s with a relatively high standard of living. The country was fairly open and seemed to have found the middle way between strict socialism and the market. However, 15 years later, five of Yugoslavia's six republics are independent countries and Kosovo, one of two autonomous provinces, is under United Nations protection. The standard of living in most of the former Republics is still below that in the 1980s. One obvious reason for the drastic economic deterioration was the series of internal wars that devastated parts of former Yugoslavia in the 1990s. The slow collapse of the Yugoslav self-managed economy in the 1980s is a less obvious reason.

Meanwhile, other former socialist countries have developed rapidly and joined the European Union (EU). Their standards of living far surpass that in most former Yugoslav countries. Slovenia is the exception. It has progressed rapidly economically and joined the EU. Table 1 gives recent figures for population, GDP and GDP per capita for the region from the EBRD Transition Report (2005).

Of the former-Yugoslav republics, both Bosnia and Herzegovina (BiH) and Serbia and Montenegro (S&M) need some extra comment. The Dayton Peace Accords which ended the conflict in Bosnia and Herzegovina at the end of 1995 set up a decentralized state with 2 Entities: the Federation of BiH (Federation) and the Serb Republic (Republika Srpska or RS). Taxes and custom administration were set at the Entity level, with only customs policy at the state level. A series of laws as well as decrees from the Office of the High Representative (OHR, set up by the UN to help

*Professor, Sarajevo Graduate School of Business, E-mail: jtesche@aol.com. Paper prepared for the "International Academic Forum on Flat Tax Rate", Center for Excellence in Finance, Bled, Slovenia, 3-4 February 2006

implement the Dayton Peace Accords) beginning in 2003 have moved indirect taxation to the State level. The international community has played a much bigger role in BiH than in other transition countries, with the exception of Kosovo.

Serbia and Montenegro (called Yugoslavia, or rump Yugoslavia until early 2003 when the name was changed) is made up of two former republics plus two autonomous provinces, Vojvodina and Kosovo. Kosovo has been under UN protection since the NATO bombing in 1999 and has its own tax system set up by UN regulations. Montenegro is part of the same country, but has a completely separate system, including a separate currency and customs. A referendum on independence is scheduled for April of this year. Vojvodina is now an integral part of Serbia.

2. Direct Taxes

Personal Income Taxes

For personal income taxes, the general movement in the region has been towards fewer rates and a decrease in the top marginal rate. Romania and Slovakia have introduced flat taxes. Tables 2 and 3 summarize the current personal income tax systems in SEE and some Central European countries. We will start with the non-former Yugoslav countries.

Albania, the poorest country in the region (Table 1) had and still has the highest number of rates, with 6, ranging from 0-30%. This is a decrease from 7 in 2004. The highest, 30%, is reached at a relatively low€4000.

Bulgaria has the second highest number of rates with 5, ranging from 0-24%, also reached at a fairly low threshold of around€3000. The top three rates are quite close at 20, 22 and 24%. A top rate of 29% was added in 2004, but dropped again in 2005, along with a 26% rate.

Romania introduced a single rate of 16% in June 2005. Previously there had been 5 rates ranging from 18-40%.

In pre-war Yugoslavia, the six republics and two provinces had a great deal of autonomy over direct taxation. They had progressive income taxes on total personal income, but it covered only income greater than a multiple of average net income. Most workers did not pay this tax. The top marginal rate was as high as 80%. The Federal level relied mainly on indirect taxes (Lydall, 1989).

The two Entities in Bosnia and Herzegovina, the Federation and the RS, still have the closest to the Yugoslav system, with its number of different taxes and rates. Only rates have changed in the Federation since new Entity laws were passed in 1996-7 to replace the pre-war Republic laws. In the RS, however, a bold experiment in regressive rates was introduced in 1998. Reform of the direct tax system in both Entities is planned for 2006.

Wages are now taxed at a single rate in both Entities: 5% in the Federation and 10% in the RS. Other sources of income are taxed separately at different rates in both: varying from 30-50% in the Federation and 25-45% in the RS. In the Federation, wage tax rates are down from 15% since 1996, changed to 10% after 2000. In the RS, a regressive system was in place between 1998 and 2001 with rates ranging from 25 to 0% (see Tesche, 2005 for a more complete history of BiH taxes).

Croatia overhauled the inherited Yugoslav tax system in1994. It now has 4 rates between 15-45%, The top rate, which is reached at more than €35.000, was added after 2000. An additional amount up to 18% can be levied on incomes by municipalities.

Macedonia has two rates of 15% and 18%. The number of rates has decreased and the rates have been decreased from 23, 27 and 35% in 2003.

For most of the 1990s, (rump) Yugolavia had a number of Federal level tax laws on the books. These were basically ignored by both Serbia and

Table 1: Background Data

	Population	GDP 2004, billion $	GDP/capita, PPP
Albania	3.2	7.6	4.929
BiH	3.8	8.2	7.168
Bulgaria	7.8	24.1	8.026
Croatia	4.4	34.3	12.336
Macedonia	2.0	5.3	6.767
Romania	21.7	73.2	8.413
Serbia & Montenegro	10.6	23.9	n.a.
Slovenia	2.0	32.2	20.853
Czech Republic	10.2	107.0	19.311
Hungary	10.1	100.3	16.596
Poland	38.2	241.8	12.876
Slovakia	5.4	41.1	13.549

Source: EBRD Transition Report, 2005.
Note: For S&M includes Kosovo.

Table 2: Personal Income Tax, 2005

Rates	Thresholds	All amounts shown in Euros. Exchange rates as of 1/1/2005.
Southeastern Europe		
ALBANIA		
0%	< 111	
5%	318	Contributions: **41.9%**
10%	716	
15%	159	
25%	3879	
30%	> 3879	
BiH: FEDERATION		
5%		Wage income
30-50%		Other income: varies by type
		Contributions: **45%**
BiH: SERB REPUBLIC		
10%		Wage income
10-25%		Other income: varies by type
		Contributions: **44%**
BULGARIA		
0%	< 702	
10%	810	Contributions: **42.4-43.1%**
20%	1350	
22%	3240	
24%	> 3240	
CROATIA		
15%	< 5018	
25%	12544	Contributions: **37.2%**
35%	35123	
45%	> 35123	
KOSOVO		
0%	< 960	
5%	3000	
10%	5400	
20%	> 5400	
MACEDONIA		
15%	< 5469	
18%		Contributions: **32.5%**
ROMANIA		
16%		Flat rate from 2005
		Contributions: **49.75-55.0%**
S&M-MONTENEGRO		
0%	< 785	
15%	To 2,615	Contributions: **40.0%**
19%	To 4,577	
23%	> 4577	
S&M-SERBIA		
14%		Salaries, agricultural, self employment income
20%		Interest, dividends, real estate, capital gains, other income
10%	> 10,990	Annual income tax on incomes over 4 times average annual salary
		Contributions: **35.8%**
SLOVENIA		
16%	< 5422	
33%	10594	Contributions: **38.1%**
37%	21438	
41%	43085	
50%	> 43085	
Central Europe		
CZECH REPUBLIC		
15%	< 3585	
20%	7169	Contributions: **47.5%**
25%	10872	
32%	> 10872	
HUNGARY		
18%	< 6256	
38%		Contributions: **41.5%**
POLAND		
19%	< 9064	
30%	18129	Contributions: **38.54-40.53%**
40%	> 18129	
SLOVAK REPUBLIC		
19%		Flat rate
		Contributions: **47.8%**

Sources: European Tax Handbook, 2005, Ministries of Finance, PriceWaterhouseCoopers CEE-CIS Tax Notes, Issue 5/1, Annual 2005, www.fxtop.com for exchange rates.

Montenegro, who pursued their own tax reforms. Montenegro introduced a global income tax in 2002. It now has 4 rates, ranging from 0-23%, with the highest reached at a low €4500. All rates were decreased by 2% in 2003.

Serbia now has what looks closer to a single rate, but is a hybrid. There is a single 14% rate on salaries, agricultural and self employment income, plus an additional 10% on annual incomes over 4 times the average salary. Some other forms of income, mostly capital income, are taxed at 20%. In addition, up to another 3.5% can be levied on salaries and wages by municipalities. Serbia had previously introduced a single rate of 20% on wage income, which was decreased to 14% in 2003. Non-wage income had been subject to progressive rates of 24-40% with the citizen's income tax since the mid-1990s. This was changed to 20% for most types of income in 2003, with 10% for agriculture and self employment income (see Tesche, 2005). A "synthetic" tax is planned for 2006, which would tax all aggregated non-wage income at 10%.

The tax system in Kosovo has been put in place via UN regulations. The personal income tax has 4 rates between 0-20%, with the maximum reached at €5400.

Finally, Slovenia has 5 rates, from 16-50%, with the highest reached at incomes more than € 43.000. The number of rates has been decreased from 6 in 2003, and most have been lowered slightly.

By comparison, the Central European countries mostly have fewer rates. The Czech Republic has the most with 4 rates, between 15 and 32%, with the maximum reached at incomes of€ 11.000. Poland follows with 3 rates between 19% and 49%, with a much higher threshold of over €18.000 for the highest rate. Hungary has only 2 rates, 18 and 38%. The higher rate is reached at a relatively low level of around €6000. Finally Slovakia has introduced a single 19% rate in 2004, replacing 5 rates ranging between 10-38%.

Note that three countries have a 0% rate: Albania, Bulgaria and Montenegro. Of these, Albania and Bulgaria allow no personal allowances or deductions. All countries without a 0% bracket have some type of personal allowance, deduction or credit, as does Montenegro.

Social contributions in the region are fairly high. The combined employer and employee contributions are under 40% of wages only in Croatia, Macedonia and Slovenia, as well as in Poland. They are close to 50% in Romania, the Czech Republic, Hungary and Slovakia. The others fall somewhere in between 40-50% (Tables 2 and 3).

Corporate Income Taxes

Corporate taxes also vary widely. While the statutory rate tells only a part of the story, the trend has been downward in most cases. Rates are now less than 20% in most of these countries. They are 9-10% in the RS, Montenegro and Serbia, and between 10-20% in Bulgaria, Croatia, Kosovo, Macedonia, and Romania. They are also between 10-20% in Hungary, Poland and Slovakia. The highest rates are in Albania (23%), Slovenia (25%), the Czech Republic (26%) and the Federation of BiH (30%). Between 1998 and 2001 corporate tax rates in the RS of BiH were regressive, with 4 rates between 20-10%.

3. Future Developments

Most countries in the region have implemented or are in the process of implementing modern direct tax systems. Although this has usually meant introducing a global income tax, there is some movement away from a fully global tax in European countries. Final withholding at a single rate on some types of income, such as interest on savings or capital gains is becoming more common. As SEE countries join the EU, or at least prepare for

Table 3: CORPORATE PROFIT TAX-Statutory Rates-2005

ALBANIA	23%
BiH-Federation	30%
BiH-Serb Republic	10%
BULGARIA	15%
CROATIA	20%
KOSOVO	20%
MACEDONIA	15%
ROMANIA	16%
S&M-Montenegro	10%
S&M-Serbia	9%
SLOVENIA	25%
CHECH REPUBLIC	26%
HUNGARY	16%
POLAND	19%
SLOVAKIA	19%

Sources: European Tax Handbook, 2005, Ministries of Finance, PriceWaterhouseCoopers, "CEE-CIS Tax Notes", Issue 5/1, Annual, 2005.

accession, they will continue to develop their tax systems. There may be more moves toward harmonization of direct tax regimes within the EU, although any changes in the tax area require unanimity.

As can be seen from the introduction of a single flat rate of income tax, as well as in other areas such as pension reform, some former socialist countries are now at the forefront of change in the tax area. It may be that the experiences in Romania and Slovakia and the others implementing bold reform will lead the way for "old" Europe.

Sources

European Bank for Reconstruction and Development, "Transition Report 2005: Business in Transition", London, 2005.

European Commission, "Tax Policy in the European Union:, EC Directorate-General for Taxation and the Customs Union, Luxembourg, Office for Official Publications of the EU Communities, 2000.

International Bureau of Fiscal Documentation, "European Tax Handbook, 2004", 2005.

Lydall, Harold, "Yugoslavia in Crisis", 1989, Oxford University Press, Oxford.

Ministry of Finance, Croatia, www.pu.mfin.hr.

Ministry of Finance, Federation of Bosnia and Herzegovina, www.fmf.gov.ba.

Ministry of Finance, Macedonia, www.finance.gov.mk.

Ministry of Finance, Montenegro, www.ministarstvo-finansija.cg.yu.

Ministry of Finance, Serb Republic, BiH, www.vladara.net.en/min/mf/html.

Ministry of Finance, Serbia, www.mfin.sr.gov.yu.

Ministry of Finance, Slovenia, www2.gov.si/zak.

Ministry of Finance and Economy of Kosova, www.mfe-ks.org.

PriceWaterhouseCoopers, "CEE-CIS Tax Notes", Issue 5/1, Annual, 2005.

Tesche, Jean, «Tax Reform in Bosnia and Herzegovina and Serbia and Montenegro: Progress and Problems», Proceedings of the Economics Faculty (Zbornik Radova Ekonomskog Fakulteta), Vol. 23, no. 2, 2005, University of Rijeka, Croatia.

Tesche, Jean, "Tax Harmonization or Competition: Croatia and Neighboring Countries", Paper prepared for the 41st ERSA Conference, 29August-1 September 2001, Zagreb, Croatia.