

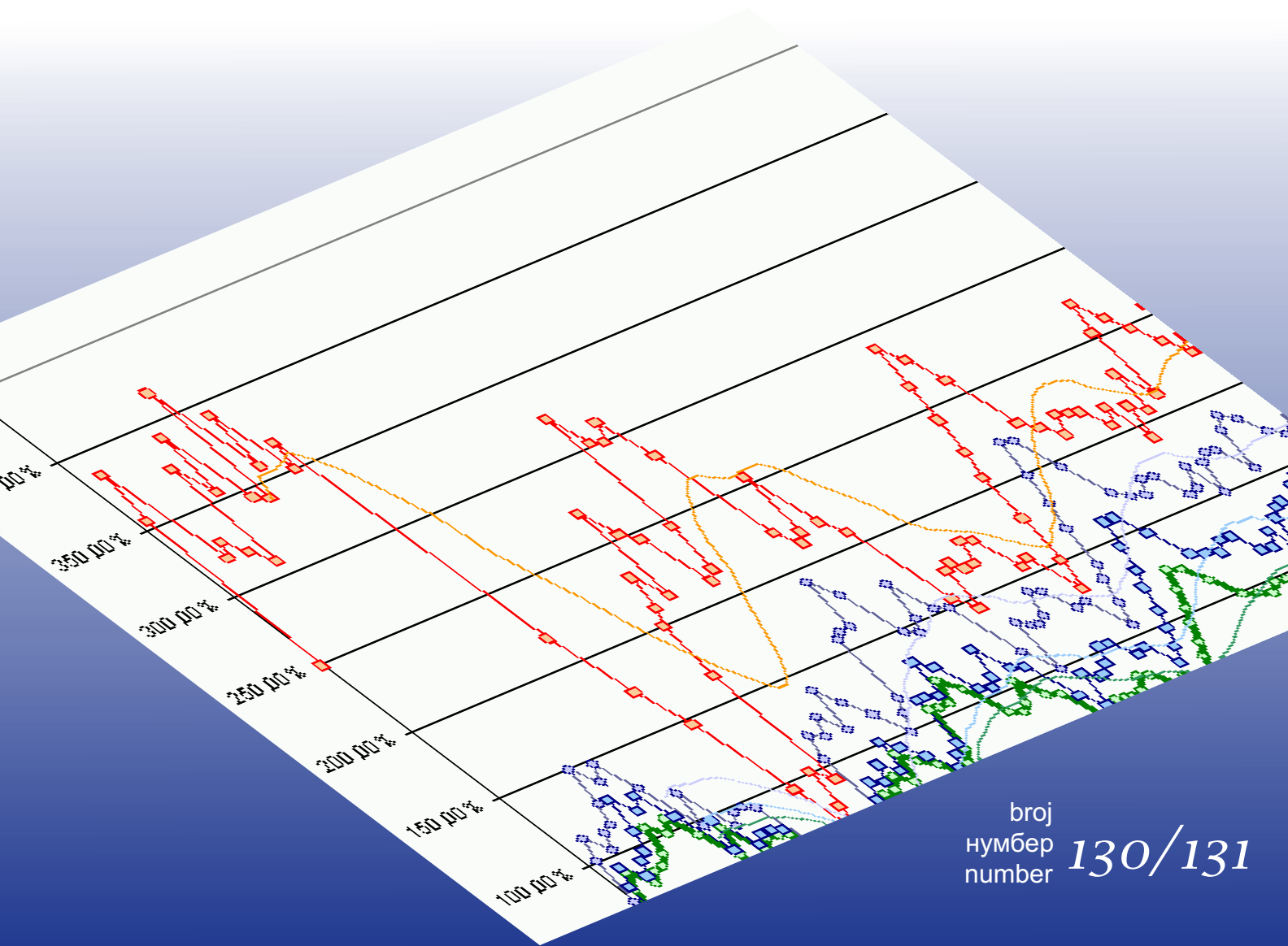
Bosna i Hercegovina  
Odjeljenje za makroekonomsku analizu  
Upravnog odbora Uprave za indirektno-  
neizravno oporezivanje



Босна и Херцеговина  
Одјељење за макроекономску анализу  
Управног одбора Управе за indirektno-  
неizravno опорезивање

Macroeconomic Unit of the Governing Board of the Indirect Tax Authority

# *Oma Bilten*



broj  
нумбер  
number *130/131*

Maj/Juni 2016

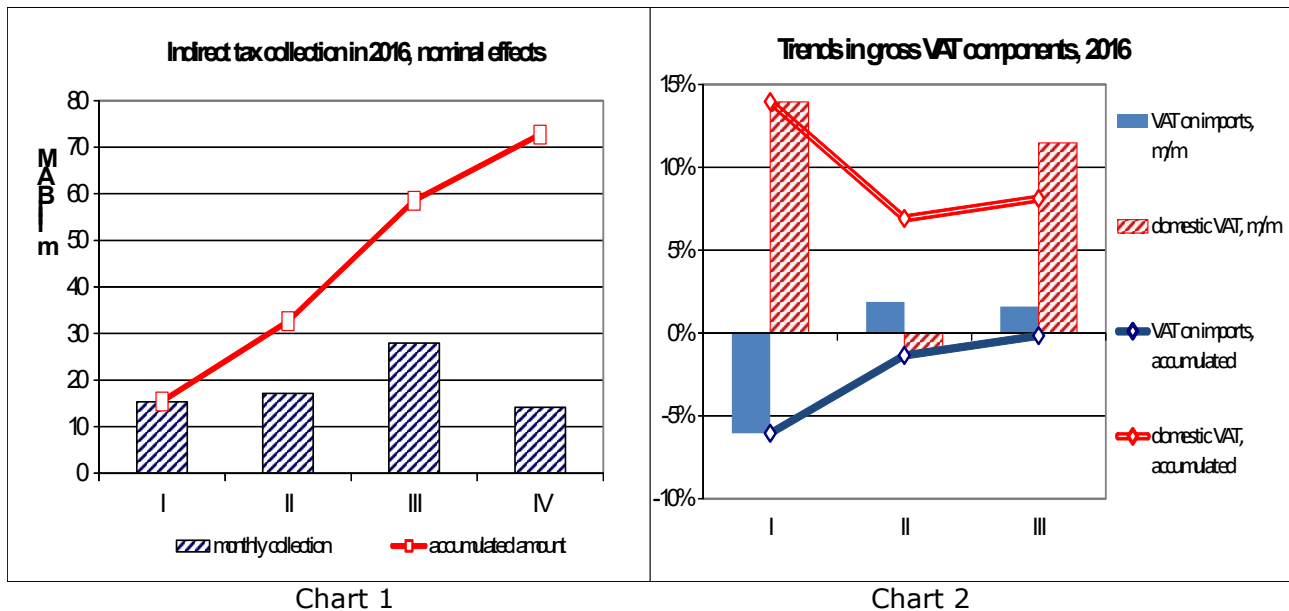
Svibanj/Lipanj 2016

Maj/Juni 2016

May/June 2016

## With this issue

The growing trend of indirect tax revenues has continued in April 2016. According to the ITA preliminary report by types of revenues, the gross revenue collection increased by 13,2 million or 2,5% in April. Refund payments were slightly lower compared to the same month of 2015. Finally, net collection was higher by 14,2 million or 3,3%. Positive trends in revenue collection in April brought increase in both gross and net cumulative collection. The net effects for the first four months amounted to 72,7 million BAM, representing an increase of 4,5% compared to a net collection in the same period of 2015 (Chart 1). The reduced payment of refunds in the amount of 11,4 million BAM contributed to the strong growth in revenues. The main generator of revenue growth in the first four months of 2016 was VAT, whose collection increased by 44,8 million BAM compared to 2015. It is necessary to take into account the high amount of unadjusted revenues of 23,1 mil BAM, of which a significant part relates to VAT, so a larger increase in VAT can be expected after adjusting payments with submitted returns. Among the other groups of revenues, the growth was recorded in revenues from excises and road tax (23 mil), while decline of 4,5 million BAM was recorded in customs revenues.



Analysis of the structure of gross VAT collection shows the positive dynamics in VAT on imports, reaching the level of collection from the same period in 2015, although it is still in the zone of negative growth. On the other hand, despite weak growth of domestic VAT in April, the cumulative growth of domestic VAT was kept to a high 6,2% (Chart 2). The growth of domestic VAT is unusual, because it exceeds the projections of consumption growth in B&H.

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## INDIRECT TAX REVENUE PROJECTIONS FOR THE PERIOD 2016-2019

### I ASSUMPTIONS

Indirect tax revenue projections for the period 2016-2019 include baseline and program scenario projections.

**The baseline scenario of revenue projections** is based on the following assumptions:

- Forecast of macroeconomic indicators by Directorate for Economic Planning (DEP) for the above period (March 2016);
- Continuation of harmonization of excise duties on cigarettes with EU standards and the application of the new cut tobacco tax policy<sup>1</sup>;
- The effects of the application of the Free Trade Agreement between BiH and the EFTA<sup>2</sup> countries in the period 2016-2017;
- Current trends in collection of indirect taxes.

Policy of excise duties on tobacco in 2016 was determined by the Law on Excise Taxes and by Decision<sup>3</sup> of the ITA Governing Board. Policy of excises on tobacco in the period 2017-2019 includes continuous annual increase in the specific excise tax on cigarettes of 0,15 BAM per pack, establishing the minimum excise duty on cigarettes (at least 60% of the weighted average price of cigarettes) and the harmonization of specific excise on cut tobacco with excise on cigarettes (at least 80% of the minimum excise tax on cigarettes).

**The program scenario of revenue projections** is based on the following changes in policies of excises/ road taxes<sup>4</sup>:

- Increasing the excise duty on oil derivatives (diesel, gasoline, heating oil, kerosene) by 0,15 BAM/l;
- The introduction of excise duty on biodiesel in the amount of 0,45 BAM/l;
- The introduction of road tax of 0,25 BAM/l on liquefied petroleum gas;
- Transformation of road tax of 0,15 BAM/l from budget revenue to earmarked revenue of directorates for roads and highways;
- The introduction of special excise duty as a earmarked revenue of health insurance funds in B&H for the following products:
  - Beer - 0,15 BAM/l
  - Soft drinks - 0,15 BAM/l
  - Alcohol – 5 BAM/l of absolute alcohol
  - Alcoholic drinks – 5 BAM/l of absolute alcohol
  - Fruit natural brandy – 2,5 BAM/l of absolute alcohol.

<sup>1</sup> The new policy is in force since 1<sup>st</sup> August 2014 ("Official Gazette B&H" no. 49/14)

<sup>2</sup> "Official Gazette - International Agreements" no. 18/14.

<sup>3</sup> The Decision on establishing the specific and minimum excise duty on cigarettes and the amount of excise tax on cut tobacco in 2016 (Official Gazette no. 94/2015).

<sup>4</sup> Amendments to the Law on Excise Duties in B&H, adopted by the ITA Governing Board in March 2016, were forwarded for further procedure in April 2016.

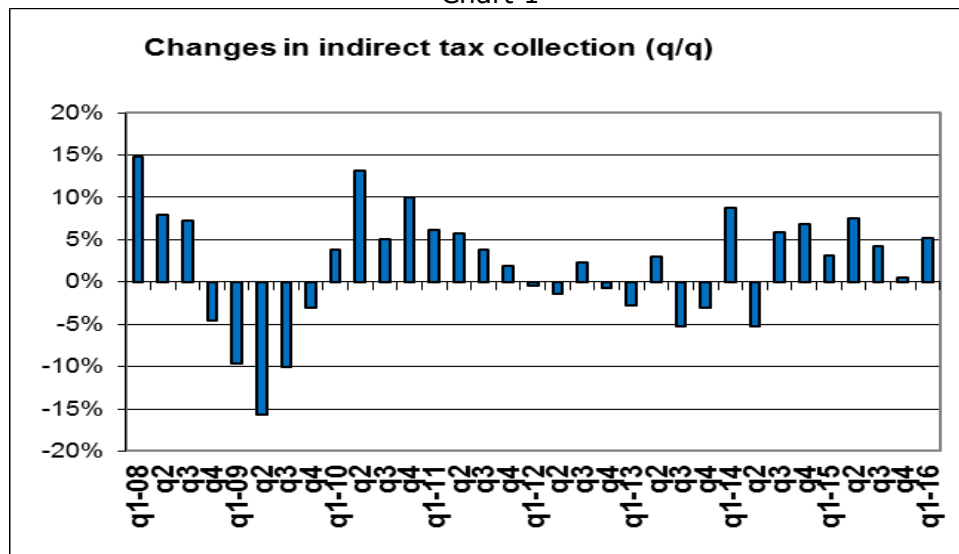
## II CURRENT TRENDS IN COLLECTION

### 2.1. Total collection

Revenue collection in the last four months has been outside the usual trends. In December 2015, the month in which collection is traditionally high due to the holidays, was recorded very bad collection, and so the annual revenue execution fell below the projected. The beginning of 2016 brought a high growth of revenues from indirect taxes, which is unusual for that period of the fiscal year, when the collection is traditionally smallest in comparison to the other quarters. It is indicative that the net collection, which in January and February increased by 4,0% and 4,4% respectively, grew faster than gross collection because of the fall in refunds of indirect taxes. The positive trends have continued in March 2016, with the difference that the net growth resulted from the growth in gross collection, while refunds remained at the same level as in March 2015. According to the ITA preliminary report, the gross collection increased by 5,7% compared to March 2015, while the net collection increased by 6,9%. In general, both the gross and net collections represent the maximum March collection since the establishment of the ITA. The cumulative gross collection grew at a rate of 3,3% in the first quarter of 2016 due to the maximum growth in revenue collection in March. Because of the reduction in refunds of 10,4 million KM, the net collection in the first quarter of 2016 was higher by 58,5 million KM or 4,9% compared to the same quarter of 2015.

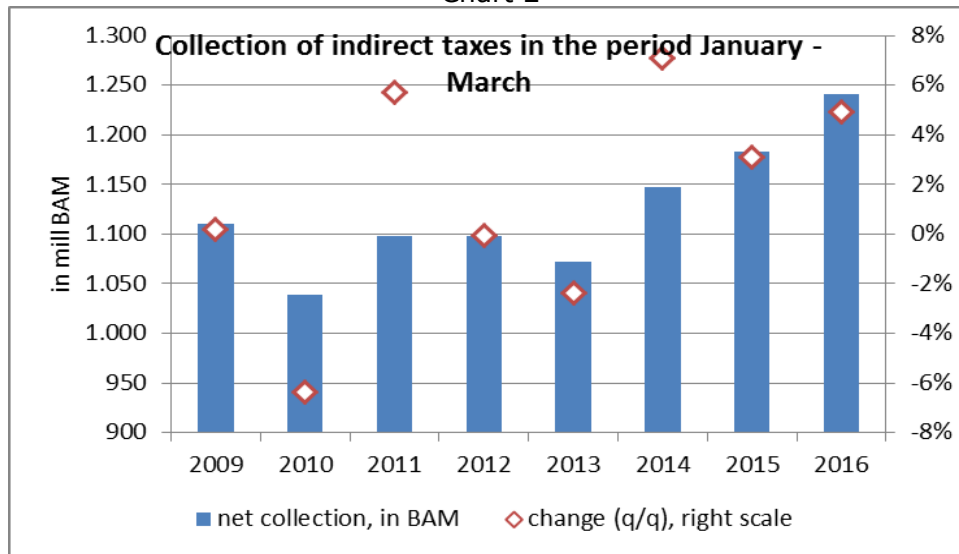
Trends in revenue collection in the first quarter of 2016 represent a significant improvement compared to the fourth quarter in which a slight revenue growth was achieved (Chart 1). Looking at the trends of the last six quarters, it could be concluded that the shortfall in the fourth quarter of 2015 was an exception, and that a record collection in the first quarter hints a high execution of indirect taxes in 2016 as well.

Chart 1



Comparison of indirect tax collection in the first quarter of 2016 compared to the first quarter of the previous year points to the conclusion that the collection of indirect taxes in nominal terms was the most successful since the establishment of the ITA (Chart 2).

Chart 2



## 2.2. Collection by types of revenues

It was recorded a strong growth in all main groups of revenues in March, which, together with the positive developments in the past two months had a positive impact on the cumulative collection.<sup>5</sup> The greatest effects in the first quarter refer to VAT (+40,5 million KM), and on excises and road taxes (+21,6 million KM). The fall in collection has been recorded only in customs revenues.

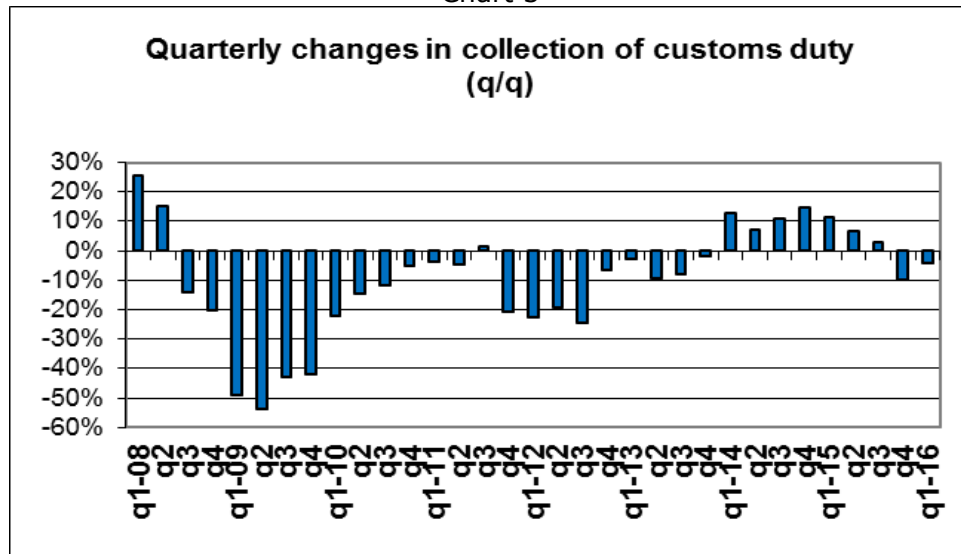
### Customs

Last year was characterized by a slowdown in customs revenues in the first half of the year, and a sharp drop in revenue in the second half. The decline in customs revenues was a result of the fall in imports of capital goods from third countries due to the completion of major investment in the energy sector (China) and the fall in imports of oil (Russia) due to reduced export of derivatives. After three quarters of positive growth, revenues from customs duties decreased by 9,9% in the last quarter of 2015. The trend of poor collection of customs duties have continued in 2016. In the first two months the imports from China fell by additional 16,8%, while from Russia even by 35,7%.<sup>6</sup> After strong decline of 15% in January, revenue collection from customs in February and March moved to the level of collection from 2015. It could not compensate for the loss of revenue from January, so the quarterly collection was lower by 4% (Chart 3). Although the Free Trade Agreement with EFTA has been in force as of 1<sup>st</sup> January 2015, the tariff reduction could not largely jeopardize the collection of customs revenues due to low weights of EFTA member states in the total import of Bosnia and Herzegovina.

<sup>5</sup> It should be noted that 18,1 million BAM of unadjusted revenues was collected in the first quarter, which have not been taken into consideration in the analysis of collection by types of revenue.

<sup>6</sup> Source: Agency for Statistics of B&H.

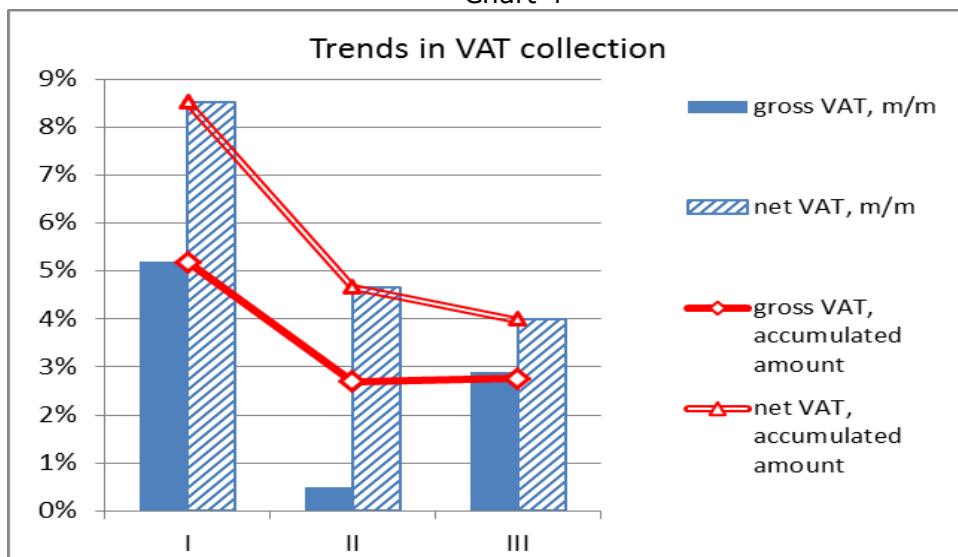
Chart 3



VAT

Collection of VAT in January 2016 represented a continuation of the unsteady trends and fluctuations from the second half of 2015. There has been strong growth in net VAT of 8,5%, which resulted from the cumulative effects of gross collection and falling refunds. The slowdown has occurred in the last two months. Increase of 4,7% was recorded in February, and of 4% in March (Chart 4).

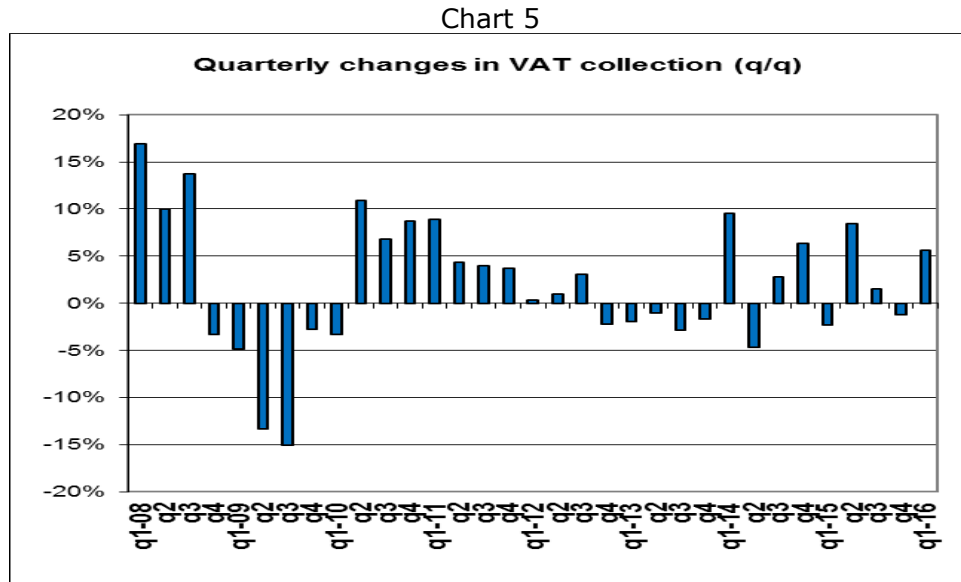
Chart 4



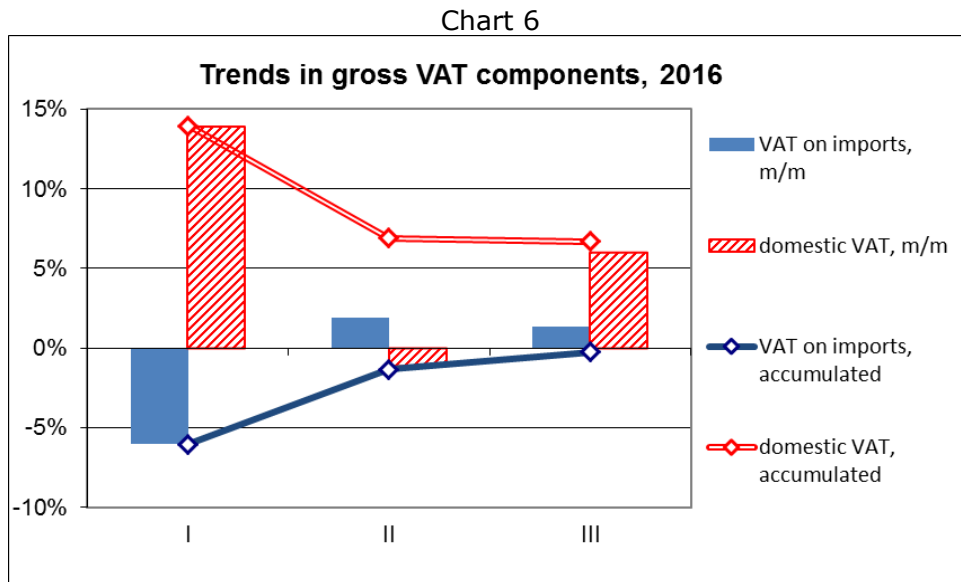
The reasons for the downward trend are the slowdown in gross collection and a gradual increase in refunds, which in March reached the level of March 2015. One of the reasons for the growth of refunds is an increase in exports in January 2016<sup>7</sup>, but due to deadlines for submitting tax returns

<sup>7</sup> According to ITA data the growth of export in January amounted to 6,5%.

and deadlines for payment of refunds the effects have been manifested in the succeeding months. Dynamics of the quarterly VAT collection shows strong fluctuations in the collection and in general positive trends in the last two years. After weak growth in the third and fall in the fourth quarter of 2015, a growth of 5,6% was reached in the first quarter of 2016 (Chart 5).



The first quarter of 2016 began with a sharp fall in VAT on imports of 6,1% in January. In contrast, domestic VAT increased at the rate of 14% (Chart 6).



Domestic VAT in January was related to the operations from December, and a decline in imports in December 2015 automatically meant the lower input VAT on returns and higher tax obligation. Slowdown in trends have occurred already in February, when a modest growth of VAT on imports and a smaller decline in domestic VAT were recorded. The positive trends in both components were recorded in March, with the increase in domestic VAT of 6%, and in VAT on imports of 1,3%.

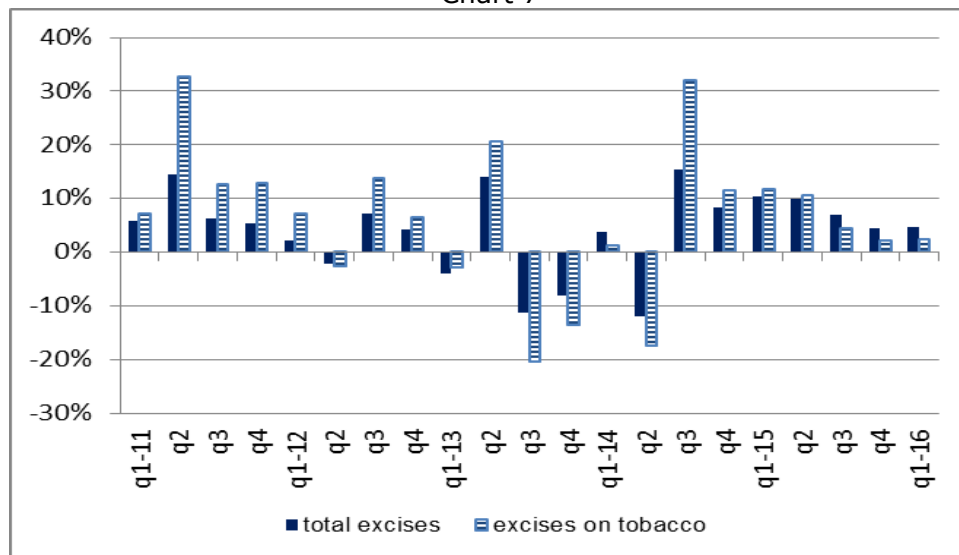
Generally, the first quarter brought the increase in domestic VAT of 6,7%, while the VAT on imports is around the level of collection in the first quarter of 2015.

The average rate of allocation from gross VAT for the refunds in the first quarter of 2016 was 24,1%, which is for 1,9 percentage points below the share from the first quarter of 2015. A comparison of VAT refunds in the first quarter of 2016 with 2015 indicates a reduction of refunds to taxpayers of 1,9% (or -4,5 million KM) and to the international projects of even 28,5% or 6,9 million KM.

### *Excises and road tax*

Collection of excises in the first two months of 2016 was at the level of collection from 2015, while in March increased by 15,4%. The largest increase was recorded in excises on oil derivatives from imports, even 55,7%. It can be assumed that such a high growth was the result of stockpiling of oil derivatives due to announcement of rising prices on the world market in the coming months. High growth rates were also reported in excises on tobacco, road tax and excises on beer. On the other hand, a significant decline in revenue was recorded in excises on domestic oil products, alcohol and alcoholic beverages, soft drinks and coffee. Positive trends in March affected the overall quarterly revenue collection from excises, which was by 4,7% higher than the collection in the first quarter of 2015.

Chart 7

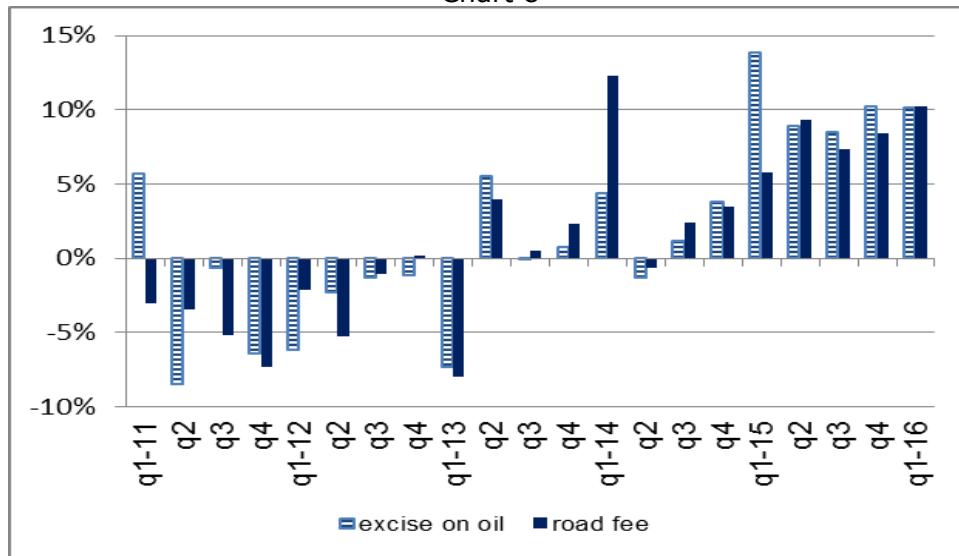


Despite the unstable beginning of year 2016, the comparison of quarterly collection shows that stable positive trend of excise collection has lasted for seven consecutive quarters, with the noticeable slowdown (Chart 7) and lower growth of revenues from excises on tobacco products in comparison to the total excises in the last three quarters. The trend can be explained by the exhaustion of the effects of the new cut tobacco policy tax (in force as of 1<sup>st</sup> August 2014) on the one hand, and by high rates of growth in revenues from excises on oil derivatives on the other hand.

Revenues from oil derivatives (excises and road tax) have been increasing continuously since the second quarter of 2013, with the exception of the slight decrease in the second quarter of 2014. The effects of collection in the first quarter of 2016 are even greater if you take into account the very high base for comparison in the first quarter of 2015 (Chart 8).

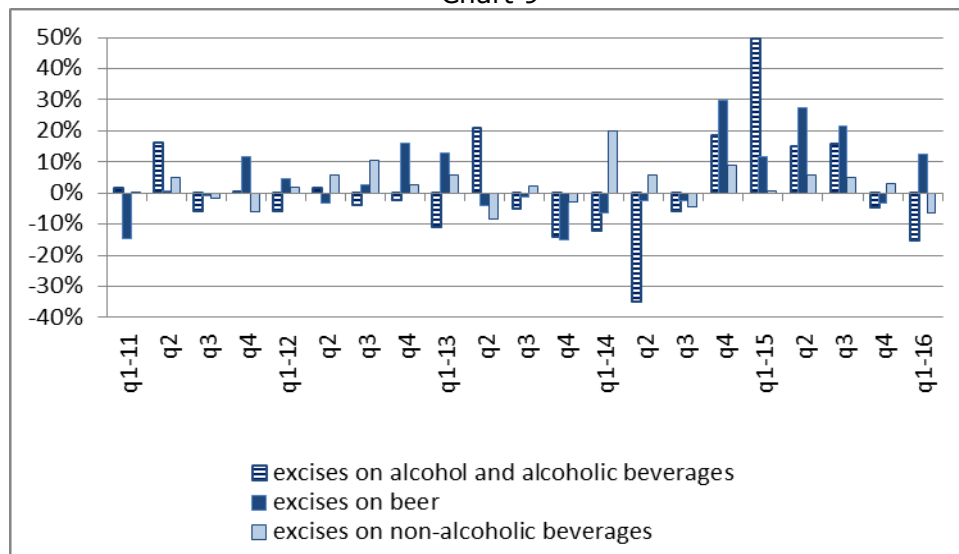


Chart 8



Despite a positive quarterly growth of 3,5%, monthly dynamics of collection of excises on coffee shows a downward trend. After enormously high growth rates of revenues from excises on alcohol and alcoholic beverages in 2015, there was a decrease of 15,3% in the first quarter (Chart 9). Analysis of monthly growth rates indicates a downward negative trend. It is similar with the revenues from excises on soft drinks where a decrease of 6,3% on the quarterly level was recorded in comparison to the same quarter of 2015. The positive trends from 2015 in the collection of excises have been retained only in excises on beer. At the quarterly level it was collected 18,8% more revenues from excises on domestic beer, and 9,2% more on imported beer.

Chart 9



**III BASELINE SCENARIO OF THE INDIRECT TAX REVENUE PROJECTIONS (2016-2019), APRIL 2016**

Table 1: Baseline scenario of the projections (2016-2019)

Type of revenue (net)	In million BAM						Projected growth rate			
	Execution	Projection					2016	2017	2018	2019
	2015	2016	2017	2018	2019					
VAT	3.255,9	3.375,9	3.490,2	3.610,0	3.731,2		3,7%	3,4%	3,4%	3,4%
Excise taxes	1.408,1	1.464,5	1.504,2	1.545,1	1.583,0		4,0%	2,7%	2,7%	2,5%
Customs	239,9	240,8	252,6	264,6	278,4		0,4%	4,9%	4,8%	5,2%
Road tax	319,8	335,5	342,9	350,1	357,1		4,9%	2,2%	2,1%	2,0%
Other	35,1	29,2	29,4	29,6	29,8		-16,8%	0,7%	0,7%	0,7%
<b>TOTAL</b>	<b>5.258,7</b>	<b>5.446,0</b>	<b>5.619,4</b>	<b>5.799,4</b>	<b>5.979,5</b>		<b>3,6%</b>	<b>3,2%</b>	<b>3,2%</b>	<b>3,1%</b>
Road tax (0,10 BAM/l)	-127,6	-134,2	-137,2	-140,0	-142,8		5,2%	2,2%	2,1%	2,0%
<b>FUNDS FOR DISTRIBUTION</b>	<b>5.131,1</b>	<b>5.311,8</b>	<b>5.482,2</b>	<b>5.659,3</b>	<b>5.836,7</b>		<b>3,5%</b>	<b>3,2%</b>	<b>3,2%</b>	<b>3,1%</b>

### 3.1. Projections for 2016

On the basis of trends in revenue collection, the annual macroeconomic projections and estimated effects of changes to the Law on Excises and the application of the Free Trade Agreement between Bosnia and Herzegovina and the EFTA countries, the projected net collection of indirect taxes for 2016 amounts to 5.446,0 million BAM, which is for 3,6 % higher than in 2015.

#### VAT

Projected VAT revenues for 2016 amounts 3.375,9 million BAM, which is for 3,7% more than the collection in the previous year. Projected annual growth rate of collection is under realized in the first quarter, and is based on the projections of macroeconomic indicators for 2016, as well as on trends in collection of these revenues, which indicate slowing down the growth of revenues in comparison to the strong growth at the beginning of the year (Chart 4 ).

#### Excises

The projected growth rate of excise revenues in 2016 amounts 4% or 56,5 million BAM in nominal terms. The highest absolute growth in revenue comes from the excises on tobacco. The expected effects of the amendments to the Law on Excise Taxes on taxation of tobacco from 2014 are largely exhausted, and further growth of revenues from excise duties, within the existing taxation policy, depends on the dynamics of aggregate consumption and income, and on measures to combat the black market and tax evasion. Projections of excises on tobacco products in 2016 are based on the implementation of decisions of the ITA Board, which had increased specific excise tax on cigarettes by 0,15 BAM per pack, and a specific excise on cut tobacco to 89,20 BAM/ kg<sup>8</sup>. It is assumed that the new tax burden would be entirely shifted to the retail prices. It is expected that the retail price of cigarettes would increase in average by 9%, and that the value of tobacco market would grow slower than the growth of aggregate consumption because of the burden of new taxes and shifting the people with low income to substitute cigarettes. The growth of the retail prices of cigarettes inevitably creates pressure to strengthen the substitution of consumption of cheaper cigarette with the consumption of cut tobacco. Since the increase in prices of cigarettes has been followed by the increase in prices of cut tobacco, it is expected the strengthening of tobacco black market, or substitution of legal tobacco products with hand-rolled cigarettes or with illegal production from non-branded tobacco. It is certain that the increase in prices of tobacco products, with the modest growth in the total value of the market, will cause a drop in cigarette consumption of at least 8%, measured by the amount of issued excise stamps. Legal substitution reduces the collected revenues from excises on tobacco products while the illegal leads to a loss of all tax revenues. In such circumstances, it is expected the modest growth in revenues from excises, nominally in the amount of 30,4 million BAM or 3,7%.

After excises on tobacco, the excises on oil derivatives contributed most to the absolute projected increase in excises (21,9 million BAM). The projected annual growth rate of excises on oil (4,7%) is below the rate achieved in the first quarter, since the high growth in the first quarter can be attributed to the stockpiling due to dynamics of oil prices on the world market.

The other categories of excise taxes were projected in accordance with the current collection trends and DEP projections. Among them, excises on beer contribute most to the absolute growth of excises while the fall in collection has been projected for the excises on alcohol.

<sup>8</sup> The decision on establishing special and minimum excise duty on cigarettes and the amount of excise tax on cut tobacco in 2016 (Official Gazette B&H no. 94/2015).

### Customs

The Free Trade Agreement between B&H and EFTA involves the phase abolition of customs duties and other levies with the fiscal effect on imports from EFTA member states in the period from 2015 to 2018. In the year preceding the beginning of the implementation of the Agreement (2014) the imports from EFTA member states represented only 0,6% of total imports in B&H<sup>9</sup>.

However, bearing in mind that the duties are usually charged on imports from the third countries, the share of customs duties collected from EFTA member states in total customs revenues amounted to 3,3%. Already in 2015, after the first year of implementation of the Agreement, imports from EFTA countries rose by 12,7%<sup>10</sup>, indicating a substitution of imports on which customs duties are levied with the duty-free imports. Nevertheless, due to the low weight of EFTA member states in the total import of B&H, the application of this Agreement could not largely jeopardize the collection of customs revenue.

Despite the estimated increase in imports (DEP), it is projected a modest growth in customs revenues for 2016 (0,4%), due to a sharp drop in imports from countries which are not subject to free trade agreements (China, Russia).

### Road tax

The projected growth rate of road tax revenues for 2016 was calculated on the basis of current collection trends and macroeconomic projections, and amounts 4,9%. The annual projected growth rate for 2016 is below the achieved growth rate of this revenue in the first quarter, for the same reason as in case of excises on oil derivatives (expected slowdown trend because of stockpiling derivatives in the first quarter).

## 3.2. Projections for 2017-2019

Projected growth rates for 2017, 2018 and 2019 are 3,2%, 3,2% i 3,1% respectively. Projections of revenues in that period are based on the projected relevant macroeconomic indicators, historical seasonal pattern of collection and projections of certain revenue categories in 2016, as well as the effects of policy changes in the areas of customs and excises duties on tobacco.

The share of increase of individual revenue in total annual growth of indirect taxes is shown in Table 2.

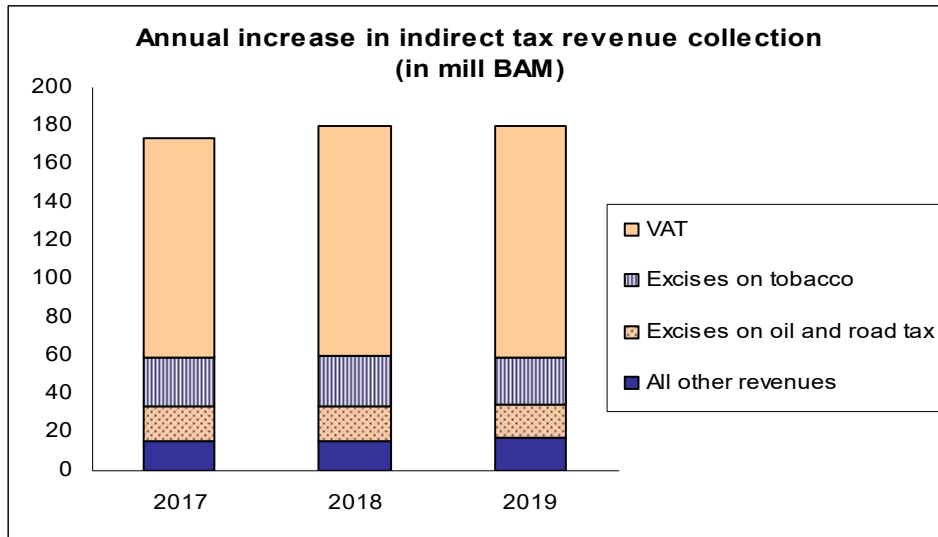
Table 2

The share in annual nominal growth (in %)	Projection		
	2017	2018	2019
VAT	65,9%	66,5%	67,3%
Excises on tobacco	14,5%	14,9%	13,8%
Excises on oil derivatives and road tax	10,5%	9,9%	9,6%
All other revenues	9,0%	8,7%	9,4%
<b>TOTAL</b>	<b>100,0%</b>	<b>100,0%</b>	<b>100,0%</b>

<sup>9</sup> Source: Agency for Statistics of B&H, [www.bhas.ba](http://www.bhas.ba).

<sup>10</sup> Ibid.

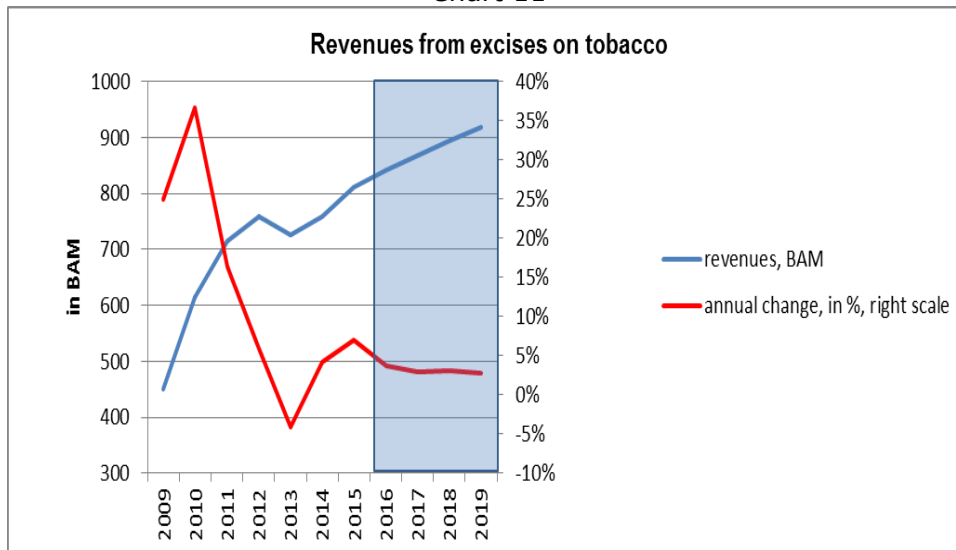
Chart 10



The largest generator of the surplus of revenues from indirect taxes in above period is VAT, due to its significant weight, and projected stable growth rates in line with projected growth rates of consumption. In all three years, VAT revenues generated over 65% of projected absolute annual revenue growth (Chart 10 and Table 2).

Revenues that contribute most to the growth of indirect taxes after VAT are excises on tobacco. Projections of excises on tobacco products are based on continued implementation of the policy of harmonizing taxation of cigarettes with the EU standards, as well as on the harmonization of taxation of cut tobacco with the taxation of cigarettes. Projections are based on the assumption of shifting the additional tax burden entirely on the retail price of tobacco products.

Chart 11



The Unit expects that, due to the increased substitution of cigarettes with cut tobacco and strengthening the black market, value of the market in tobacco products would grow gradually, while the drop in cigarette consumption would be more pronounced. In such circumstances, in

2017, 2018 and 2019 it can be expected a continuation of the trend of slowing down the growth in revenues from excises of 3%, 3,1% and 2,8% respectively and declining nominal effects (Chart 11).

In accordance with the macroeconomic projections of DEP a stable growth rates of excises on oil derivatives and road tax were planned for the period 2017-2019. Taken together, they constitute approximately 10% of the absolute projected annual revenue growth.

All other revenues contribute less than 10% to the absolute growth of indirect taxes. These include customs, other unmentioned excises and other revenues. Projections of customs follow the projected growth rates of imports and include the effects of the Free Trade Agreement between Bosnia and Herzegovina and the EFTA.

### 3.3. Differences from the previous projections

Differences from the projections prepared in October 2015 are shown in Table 3.

Table 3

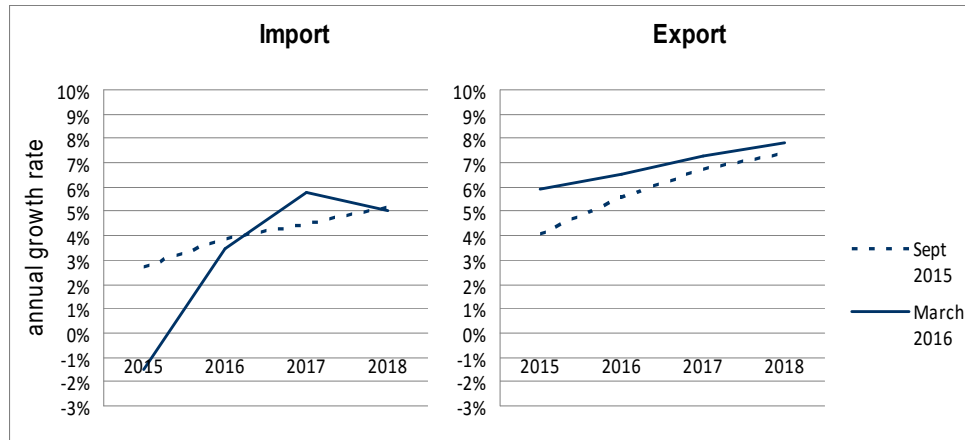
Differences from the projections prepared in October 2015 (in million BAM)	Execution	Projection		
	2015	2016	2017	2018
VAT	-20,3	8,7	13,7	-0,1
Excise taxes	2,4	12,1	-2,1	-13,4
Customs	-8,8	-16,7	-16,5	-19,4
Road tax	0,8	10,5	10,1	8,9
Other	11,0	4,9	4,9	5,0
<b>TOTAL</b>	<b>-14,9</b>	<b>19,5</b>	<b>10,0</b>	<b>-19,0</b>

#### *Execution for 2015*

The cumulative growth of revenues from indirect taxes (4,3%) in November 2015 was above the annual projections for 2015 (4%), but an unexpected decline in revenue in December (2%) caused the lower total collection in 2015 (3,7%) than the projected level. The decline in imports of even 8,2% in December last year<sup>11</sup> jeopardized the revenue collection in that month, mostly VAT on imports and customs. Imports in B&H in 2015 were far below the projections of DEP from September of the same year (Chart 12).

<sup>11</sup> Source: Agency for Statistics of B&H, [www.bhas.ba](http://www.bhas.ba).

Chart 12: Projections of import and export growth rates (nominal rates)



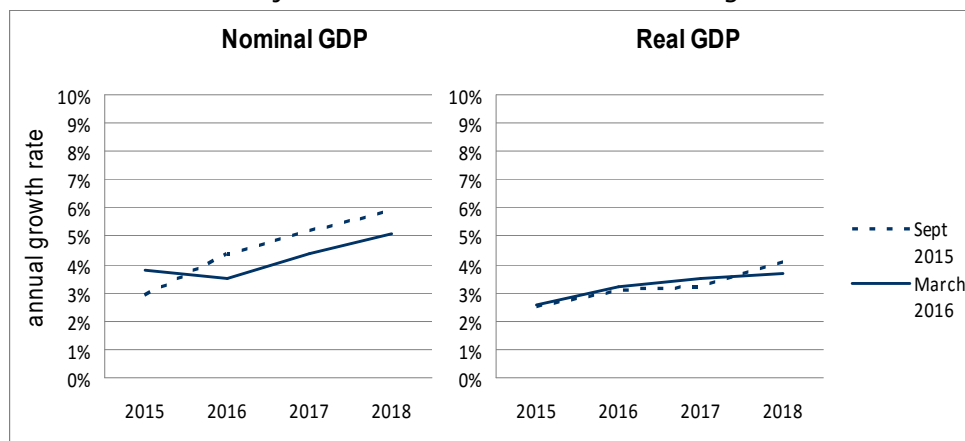
Source: Directorate for Economic Planning

For the above reasons, most differences between collected revenues in 2015 and projections from October refer to the VAT revenues and customs duties (Table 3). The decline in imports in the last quarter of 2015 which was not in line with DEP projections led to a significant shortfall in revenues from customs duties in comparison with the projection (-8,8 million KM). Revenues from VAT were lower by 20,3 million KM than the projection, but this can be attributed not only to the dynamics of imports in December but to the large amount of unadjusted revenues (16,5 million KM) at the end of 2015 as well. According to current indicators, the largest amount of unadjusted revenues is mainly related to revenues from VAT. These revenues are included in the item "Other" in Table 3, and the excess of the 11 million KM is almost entirely attributable to them. Observed as a whole, revenue collection in 2015 was lower by 14,9 million KM than the projected amount in October.

*Projections for the period 2016-2019*

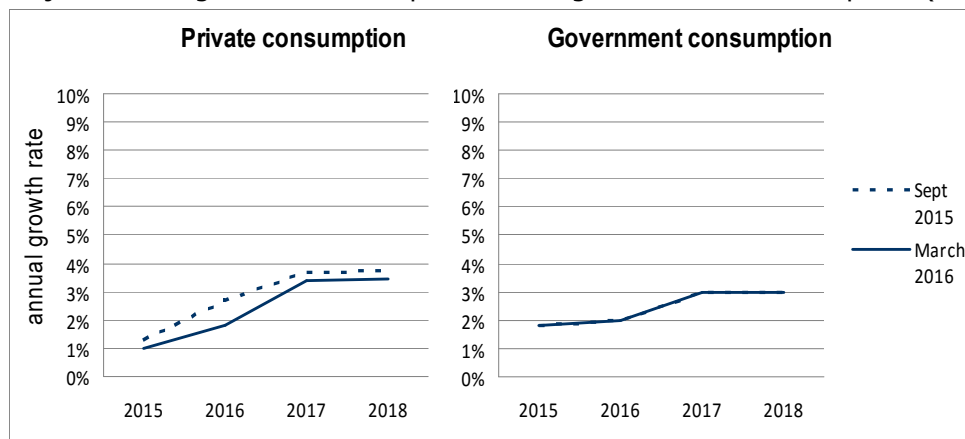
The projections for 2016 have been revised upwards by 19,5 million or 0,4% compared to the October projections. Although there were no significant changes of the projections of growth rates of GDP and consumption by the DEP (Charts 13 and 14), the projections of revenues from VAT, excises on oil derivatives and road tax have been increased due to the positive trends in collection in the first quarter of 2016.

Chart 13: Projections of nominal and real GDP growth rates



Source: Directorate for Economic Planning

Chart 14: Projections of growth rates of private and government consumption (nominal rates)



Source: Directorate for Economic Planning

Projections of revenues from customs were reduced due to the lower realization in 2015, a slight reduction in projections of imports and the fall of the weight of imports from the countries which are not subject to free trade agreements. Projections of excises on tobacco have been reduced, and the reason for the lower growth in revenues from excises on tobacco products in comparison to the October projections were the lower growth rates of aggregate consumption and worse current trends than the projected.

Projections for 2017 and 2018 have been revised in line with the macroeconomic projections and the projected amounts of certain types of revenues for 2016. Expressed in %, projections for the period 2016-2019 have been revised in the range of -0,3% to 0,4% (Table 4).

Table 4: Differences between projections from April 2016 and October 2015 in %

Time of preparation of the projection	2015	2016	2017	2018	2019
October 2015	5.273,6	5.426,5	5.609,3	5.818,4	n/a
April 2016	5.258,7	5.446,0	5.619,4	5.799,4	5.979,5
Change in %	-0,3%	0,4%	0,2%	-0,3%	n/a

### 3.4. Risks to projections

Given the basic settings of the projections of indirect taxes and the overall economic conditions in B&H and in the world, the achievement of the projected level of indirect tax revenues during the period 2016-2019 is susceptible to the following risks:

- Indirect tax revenue projections are closely linked to the projections of macroeconomic indicators by DEP. Each deviation from these parameters from the projected values represents a risk to revenue projections.
- Poorer economic recovery of the major export partners of B&H (EU, CEFTA countries) increases the level of risk for the achievement of the macroeconomic projections, and thereby also of the overall indirect tax revenue projections.
- Introduction of the additional earmarked excise tax on cigarettes would be a strong shock to the legal cigarette market and revenues from excise duties. Shift in dynamic of the adjustment of the overall minimum excise in B&H with minimal excise in the EU



would adversely affect the price relations of domestic cigarettes and cigarettes from the neighboring countries to the detriment of Bosnia and Herzegovina, which would ultimately lead to a reduction in domestic production of cigarettes and losses in excise revenues and the associated VAT.

- Potential changes in VAT policies, e.g. differentiated rates of VAT, in addition to fiscal losses and macroeconomic implications such as market distortions, can destabilize the existing VAT system and revenue collection, reduce efficiency of operation of the ITA, burden businesses, and significantly increase the risk of frauds.
- Any change in taxation policy of oil derivatives that would imply increase of earmarked road tax would lead to an increase in the gap in taxation of substitutes (diesel and heating oil) and distortion on the derivatives market, with the negative consequences for the revenues from road tax.

#### IV PROGRAM SCENARIO

Given that the proposal of amendments to the Law on Excises was in the procedure in the Council of Ministers at the time of preparation of projections, and bearing in mind the complex legislative process in the area of indirect taxation, it was not possible to reliably predict the moment of entering into force the above amendments. For this reason, the Unit assessed the effects of amendments to the law **on the annual basis**. The estimates were made on the basis of trends in 2015 and have a **static** character, since the primary purpose of the projections is to show the initial effects on revenues. After the adoption of the draft amendments to the Law, the Unit will revise the baseline projections by including the dynamic effects of amendments to the Law.

##### 4.1. Estimates of the effects of taxation of oil derivatives

Given the scope of proposed amendments to the Law on Excises, the estimates of the effects of additional taxation of oil derivatives are narrower, because they do not include the estimates for liquefied petroleum gas.<sup>12</sup> The introduction of excise duty on bio-diesel is a measure which is supposed to suppress the current substitution of taxed diesel consumption with the untaxed biodiesel. Regarding that, consumers are expected to refrain from the use of biodiesel and to return to use of diesel, so the additional revenues from excises on biodiesel can not be expected but the increase in revenues from excises on diesel. Estimates of the effects of changing the rates of excises on derivatives were carried out on the basis of the structure of imported derivatives and domestic derivatives placed on the market in 2015. Static estimates assume that there will be no changes in the structure of consumption of derivatives. Secondly, it is expected that the quantities of released diesel used by the railways, mines and power plants will remain unchanged.

The initial static effects of increased excise duties on diesel/biodiesel, gasoline and heating oil are estimated at 234,5 million BAM annually. However, given that the rise in the tax burden on oil derivatives would lead to higher retail prices, the reduction in derivatives consumption is certain, and thereby the reduction in expected effects on the revenue from excises.

According to the proposal, the road tax of 0,15 BAM/l which is currently being used for budget financing, will be transformed into an earmarked road tax for financing the construction of roads and highways, and will be added to the existing earmarked road tax (currently 0,10 BAM/l). This

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<sup>12</sup> The analytics of the IT system of the ITA doesn't allow to split of the amount of liquefied petroleum gas according to the usage (for motor fuel and industry/households), which prevents an estimate of revenues that would be collected from the road tax on liquefied petroleum gas which is used as a motor fuel.

intervention will not bring any increase in revenues from road taxes, except for the additional 3 million BAM approximately, which is estimation on the amount of biodiesel.

The effects on revenues from road taxes will be achieved only with road taxes which will be paid on the liquefied petroleum gas. Considering the overall growth of the excise burden on derivatives, a decrease in consumption due to rising retail prices will affect revenues from road taxes.

#### **4.2. Estimates of the effects of introduction of the earmarked excise tax for health insurance funds**

Bearing in mind the manifestation time of the effects of amendments<sup>13</sup> to the Law on Excises which introduced differentiated excise duty on beer, the trends from the fourth quarter of 2015 are relevant for the estimates of the effects of increasing the excises. According to quarterly review the growth was recorded only in revenues from excises on soft drinks, while a drop in revenues was recorded in excises on beer and alcohol / alcoholic beverages. Assessment of the effects of introduction of earmarked excise duties on wine, brandy and alcohol / alcoholic beverages was made by approximating the data from the records of issued stamps in December, the month in which the maximum revenue collection from excises was achieved<sup>14</sup>.

The initial static effects of increasing excise taxes on beer, alcohol, alcoholic and soft drinks are estimated at 67,4 million BAM annually.

#### **4.3. The implications on the revenue allocation**

Under the current Law only road tax of 0,10 BAM/l of derivative has an earmarked character and serves to finance entity road directorates, while revenues from excises on all excise products and the road tax of 0,15 BAM/l are used to finance government budgets in Bosnia and Herzegovina. Except for the impact on the total level of collected excises and road taxes, the proposed amendments to the Law on Excises have the effects on the allocation of revenues in B&H.

Since the current road tax of 0,15 BAM/l is used for budget financing, its change to an earmarked revenue reduces the revenues for budget financing. The loss of revenue from road tax of 0,15 BAM/l is compensated by increasing the excise tax in the same amount. The net effect on budget financing of the increase in excise taxes is estimated at approximately 35,4 million KM, i.e. at the level of additional taxation of biodiesel and heating oil, which are not burden with road tax according to the current regulations.

On the other hand, change of the character of road tax of 0,15 BAM/l from non-earmarked to the earmarked revenue significantly increases revenues of directorate for roads and highways, while the introduction of earmarked excises for health insurance funds increases revenues of funds.

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<sup>13</sup> These amendments to the Law on Excise Tax came into force on 1<sup>st</sup> September 2014

<sup>14</sup> In terms of excise taxation, the group of products which includes alcohol and alcoholic beverages is split into wine, alcohol, brandy and other alcoholic drinks. The revenues are not shown analytically in the financial statements of the ITA, but only synthetically. The only analytical review is the review of issued control stamps.

#### 4.4. Risks

The realization of the program scenario is subject to the following risks:

##### *Oil derivatives:*

- Taking into account the relative relationships of the prices, the increase in excise duties will inevitably weaken the competitive position of B&H in the regional market of derivatives, so weakening of the cross-border and transit retail of derivatives can be expected, which was one of the important factors of the strong growth in revenues from excises and road taxes in 2015 and in the first quarter of 2016;
- The current policy of energy taxation encouraged the illegal consumption of heating oil as the motor vehicle fuel. Although the proposed amendments keep the same gap between the taxation of heating oil and diesel, it is certain that the increase in excise duty on diesel will boost incentives to use fuel oil, due to nominal growth of retail prices of diesel;
- Any increase in the oil price on the market will have a negative effect on consumption of derivatives, which will have a negative impact on both the budget revenues (excises, VAT) and earmarked revenues from taxes on oil derivatives (road tax).

##### *Earmarked excises for health services:*

- The increases in taxes on alcohol, beer, alcoholic and soft drinks are expected to bring a fall in consumption. The fall in consumption will not only have a negative impact on the revenues collected for health services, but will have a negative budgetary implications as well;
- The increase in taxes on those products will certainly lead to distortions in the market (strengthening the black market, the appearance and expansion of illegal bottlers, illegal sale on the markets etc.), which will jeopardize the business of domestic producers, and hence employment, and increase tax evasion not only in the area of indirect taxation but in areas of direct taxation and social contributions as well;
- The drastic increase in taxes for the health services produces the "boomerang" effect. Strengthening the black market and the appearance of poor-quality cheap products that haven't been the subject of health, sanitation and other controls will endanger the health of citizens, which will recurrently create additional burdens for health funds.

## Consolidated reports

(Author: Aleksandra Regoje)

### Table 1 (Consolidated report: B&H institutions, entities, SA)

The preliminary consolidated report includes

- revenues from indirect taxes collected by the Indirect Tax Authority on the Single Account,
- transfers from the ITA Single Account,
- revenues and expenditures of the institutions of Bosnia and Herzegovina,
- revenues and expenditures of the budget of the Federation of Bosnia and Herzegovina,
- revenues and expenditures of the budget of the Republika Srpska.\*

Report doesn't include unadjusted revenues collected on ITA SA.

### Table 2 (Consolidated report: B&H Institutions, entities, BD)

Preliminary consolidated report includes:

- revenues and expenditures of the budget of Institutions of Bosnia and Herzegovina,
- revenues and expenditures of the budget of the Federation of B&H,
- revenues and expenditures of the budget of the Republika Srpska\*,
- revenues and expenditures of the budget of Brčko District.

### Table 3 (Consolidated report: General Government)

Preliminary consolidated report includes:

- revenues and expenditures of the budget of Institutions of Bosnia and Herzegovina,
- revenues and expenditures of the budget of the Federation of Bosnia and Herzegovina, cantons, cantonal directorates for roads, municipalities and funds in FB&H,
- revenues and expenditures of the budget of the Republika Srpska\*, directorates for roads/highways, municipalities and funds,
- revenues and expenditures of the budget of Brčko District and funds in BD

*\*Includes: (A) Budget of the Republic and extra-budgetary funds recorded in Treasury General Ledger of the RS, (B) total foreign debt for the projects realized through municipalities and companies, and (C) Budget users who have their own bank accounts (including foreign project implementation units established by ministries)*

**The Fund for Pension and Disability Insurance of RS is included in the budget of RS as of 1<sup>st</sup> January 2016**

**Preliminary report: B&H Institutions, entities and SA, I-III 2016**

<i>(in million BAM)</i>	I	II	III	Total
Revenue	493,3	543,2	604,9	1.641,4
Taxes	409,8	440,1	491,1	1.341,0
Direct taxes	20,7	30,0	58,7	109,4
Taxes on income, profits and	20,0	29,0	57,5	106,5
Taxes on property	0,7	1,0	1,2	2,9
Indirect taxes (net)	389,0	410,1	432,4	1.231,5
VAT	236,5	265,9	268,9	771,2
Excises	118,1	98,3	110,6	326,9
Road fee	21,3	24,6	28,0	73,9
Customs	12,1	20,0	23,4	55,4
Other indirect taxes	1,1	1,4	1,6	4,1
Other taxes	0,0	0,0	0,0	0,1
Social security contributions	49,3	61,9	62,6	173,9
Grants	1,3	0,5	2,9	4,6
Foreign grants	0,2	0,3	2,8	3,3
Transfers	1,1	0,2	0,1	1,4
Other (non-tax) revenue	32,9	40,7	48,3	121,9
Expenditure	487,4	510,4	542,5	1.540,3
Expense	481,3	507,9	539,0	1.528,1
Compensation of employees	136,2	131,6	135,7	403,5
Use of goods and services	14,7	19,5	30,4	64,6
Social benefits	132,5	138,3	136,7	407,5
Interest	5,5	13,8	18,5	37,8
Interest payments to non-	3,3	9,9	11,4	24,6
Interest payments to residents	2,2	3,9	7,2	13,2
Subsidies	0,1	2,8	9,0	12,0
Grants, transfers (incl. transfers from	188,6	197,9	197,4	583,9
Other expense	3,7	4,0	11,2	18,8
Net acquisition of nonfinancial assets	6,1	2,6	3,5	12,2
Acquisition of nonfinancial assets	6,5	3,2	6,5	16,2
Disposal of nonfinancial assets	0,4	0,7	3,0	4,0
Gross/Net operating balance (revenue minus expense)	12,0	35,3	65,9	113,2
Net lending /borrowing (revenue minus expenditures)	5,9	32,7	62,4	101,1

Table 1.

\*\* transfers from SA include unconsolidated transfers to BD, cantons, municipalities and road funds

**Preliminary report: B&H Institutions, entities and BD, I-III 2016**

<i>(in million BAM)</i>	Q1
<b>Revenue</b>	<b>1.187,0</b>
Taxes	883,5
Direct taxes	116,4
Taxes on income, profits and capital gains	111,4
Taxes on payroll and workforce	1,9
Taxes on property	3,1
Indirect taxes	766,8
Other taxes	0,3
Social security contributions	173,9
Grants	4,8
Foreign grants	3,3
Transfers	1,5
Other (non-tax) revenue	124,8
<b>Expenditure</b>	<b>1.075,6</b>
Expense	1.061,9
Compensation of employees	419,4
Use of goods and services	73,2
Social benefits	412,0
Interest	38,1
Interest payments to non-residents	24,6
Interest payments to residents	13,5
Subsidies	17,0
Grants, transfers	83,4
Other expense	18,8
Net acquisition of nonfinancial assets	13,7
Acquisition of nonfinancial assets	17,7
Disposal of nonfinancial assets	4,0
<b>Gross/Net operating balance (revenue minus expense)</b>	<b>125,1</b>
<b>Net lending /borrowing (revenue minus expenditures)</b>	<b>111,4</b>

Table 2.

**Preliminary report: General Government, I-III 2016**

<i>(in million BAM)</i>	Q1
<b>Revenue</b>	<b>2.799,1</b>
Taxes	1.476,5
Direct taxes	273,7
Taxes on income, profits and capital gains	235,4
Taxes on payroll and workforce	2,5
Taxes on property	35,7
Indirect taxes	1.198,3
Other taxes	4,5
Social security contributions	1.002,7
Grants	9,0
Foreign grants	6,7
Transfers	2,3
Other (non-tax) revenue	310,9
<b>Expenditure</b>	<b>2.680,1</b>
Expense	2.615,3
Compensation of employees	827,3
Use of goods and services	478,2
Social benefits	1.120,0
Interest	47,9
Interest payments to non-residents	26,0
Interest payments to residents	21,9
Subsidies	39,0
Grants, transfers	21,3
Other expense	81,7
Net acquisition of nonfinancial assets	64,7
Acquisition of nonfinancial assets	75,0
Disposal of nonfinancial assets	10,3
<b>Gross/Net operating balance (revenue minus expense)</b>	<b>183,7</b>
<b>Net lending /borrowing (revenue minus expenditures)</b>	<b>119,0</b>

Table 3.