

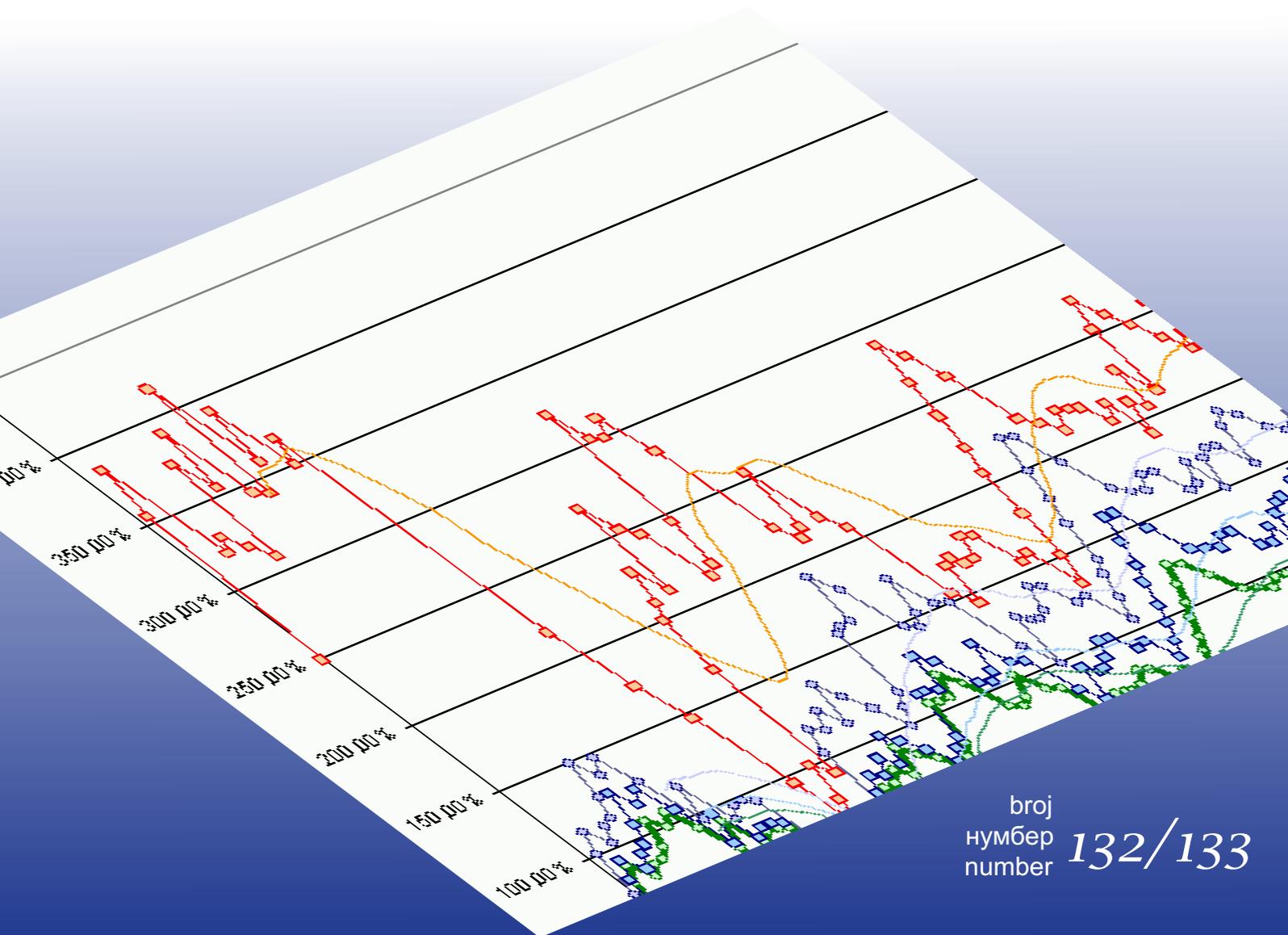
Bosna i Hercegovina
Odjeljenje za makroekonomsku analizu
Upravnog odbora Uprave za indirektno-
neizravno oporezivanje



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



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With this issue

According to the preliminary report, it was collected 547 million BAM gross revenues from indirect taxes on the Single Account of ITA in July 2016, which is 30,4 million BAM less than in the same month of 2015. Since the payments of refunds decreased by 7,3 million BAM, the fall in net collection was slightly lower, 24,2 million BAM or 5%, compared to a net collection in July 2015. The decrease in net collection has been recorded for the first time after six months of consecutive positive trends, and main reason is two working days less in July 2016 compared to the same month of 2015. Because of the lower gross collection, the cumulative net surplus in 2016 was reduced to 79 million BAM (Chart 1).

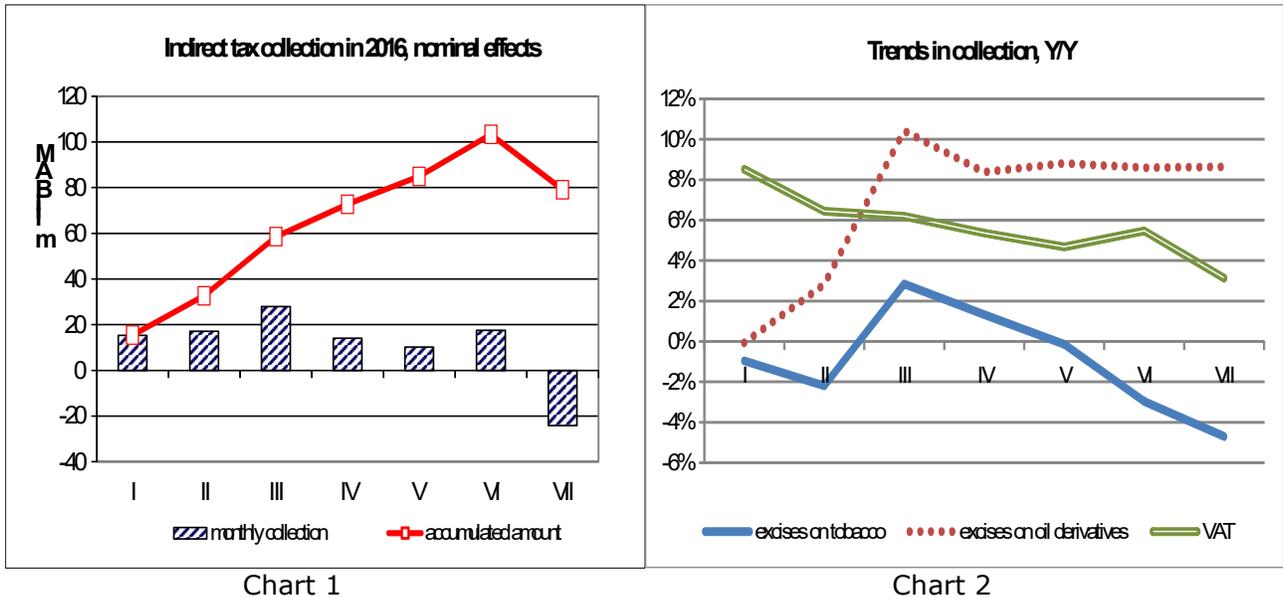


Chart 2 shows the trends in cumulative collection of certain types of indirect taxes which, given their dominant share in total revenues from indirect taxes, also dictate current trends in 2016. The most stable growth for seven months of 2016 was recorded in revenues from VAT and excises on oil derivatives. Excises on oil derivatives were unstable only in January 2016, while in other months their growth has been high and stable. On the other hand, negative trends in collection of excises on tobacco have pointed to reactivation and strengthening the black market of fine cut tobacco and cigarettes in B&H.

The Bulletin also provides an analysis of current trends in taxation of oil derivatives and implications of the proposed amendments of the Law on Excises to the derivatives market in B&H.

Dinka Antić, PhD
Head of Unit

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Tax policy changes in the light of trends in oil derivatives market

(prepared by: Dinka Antić, PhD)

Taxation policy of oil derivatives has not been changed since 1st of July 2009 when the earmarked road tax from the price of oil derivatives has been introduced. Since then there have been many initiatives to introduce new earmarked taxes (e.g. for railways, to create energy reserves, etc) or to increase the existing earmarked road tax for the construction of highways.

The last proposal of amendments to the Law on Excise Duties in B&H envisages the increase in excise duties on oil derivatives and transformation of the current non-earmarked road tax in an earmarked road tax for the construction of roads and highways.

TAXATION POLICY OF OIL DERIVATIVES IN B&H

The adoption of the first state Law on Excise Duties in B&H at the end of 2004 meant the integration of policies, legislation, administration and collection of revenue from taxes on oil derivatives at the B&H level. VAT, excise duties and road taxes are levied from the retail price of derivatives on imports and sales of oil derivatives. In addition to non-earmarked road tax of 0,15 BAM/l, which is inherited from the Entities and the District, the new Excise Law, which is in force as of 1st of July 2009, introduced also an additional earmarked road tax for the construction of highways in B&H in the amount of 0,10 BAM/l of derivative. Non-earmarked road tax of 0,15 BAM/l is considered as the budget revenue and is included in regular distribution of revenues from indirect taxes by allocation coefficients determined by the Governing Board of the Indirect Taxation Authority (ITA GB). Non-earmarked road tax of 0,10 BAM/l represents the revenue of the Entity Directorates of Highways and is distributed according to specific coefficients determined by the ITA GB.

Tax policy of oil derivatives involves a differentiated approach:

- Given the type of derivative, lower rates for diesel, kerosene and heating oil are prescribed;
- Refunds on excises on diesel used for heating commercial and residential premises and greenhouses are enabled;
- Heating oil is not levied by road taxes because it is assumed to be used to heat commercial and residential premises and not to drive motor vehicles;
- Mines, power-plants and railways are exempt from paying road taxes.

Review of current rates of excise and road taxes on oil derivatives is given in Table 1.

Table 1 Review of current rates of excise/road taxes on derivatives (in BAM)

	Excise duty	Earmarked road tax		Total
		Road tax 0,15 BAM/l	0,10 BAM/l	
diesel	0,30	0,15	0,10	0,55
kerosene Unleaded	0,30	0,15	0,10	0,55
gasoline	0,35	0,15	0,10	0,60
Motor gasoline	0,40	0,15	0,10	0,65
Heating oil	0,30	-	-	0,30

Proposed amendments to the Law on Excise Duties include the following:

- An increase in excise rates on oil derivatives by 0,15 BAM / l
- Transformation of the road tax of 0,15 BAM / l into an earmarked road tax for the construction of roads and highways;
- Taxation of biodiesel by excise and road tax at the level of diesel taxation;
- Taxation of liquefied petroleum gas with the road tax.

Review of proposed rates of excise and road taxes on oil derivative is given in Table 2.

Table 2 Proposed rates of excise/road taxes on derivatives (in BAM)

	Excise duty	Earmarked road tax	Total	Increase
diesel	0,45	0,25	0,70	0,15
kerosene	0,30	0,25	0,55	0,00
Unleaded gasoline	0,50	0,25	0,75	0,15
Motor gasoline	0,55	0,25	0,80	0,15
Heating oil	0,45	-	0,45	0,15
Liquefied petroleum gas	0,00	0,25	0,25	0,25
biodiesel	0,45	0,25	0,70	0,70

Comparing the total excise burden on oil derivatives under the existing Law and proposed amendments it can be concluded that the most important derivatives will be additionally taxed with 0,15 BAM/l (column "increase" in Table 2) + VAT. Excise burden on kerosene remains unchanged.

Given that diesel and biodiesel are substitutes of non-taxed biodiesel under the current Law it represents an incentive to the legal tax evasion. Introducing excise duties on biodiesel which are identical to excise duties on diesel, consumption of biodiesel as a substitute of diesel will be reduced to a minimum. Taxation of liquefied petroleum gas with road tax aims to internalize the external costs paid by the State for the construction and maintenance of roads and highways at the expense of drivers of motor vehicles on liquefied petroleum gas as it is now the case with drivers who used diesel and gasoline for motor vehicles.

TRENDS IN DERIVATIVES MARKET¹

In 2015 over 1,2 million tons of derivatives was imported and placed in the market, which is a historical maximum in the last 13 years for which the Unit has data (Chart 1). Compared to 2014 there was an increase of 9,4% in the total amount of taxable oil derivatives (Chart 2, line "total"). At the same time, the import of derivatives increased by 12,8% and the amount of domestic derivatives by 5%.

Such strong growth could be explained by the action of several factors:

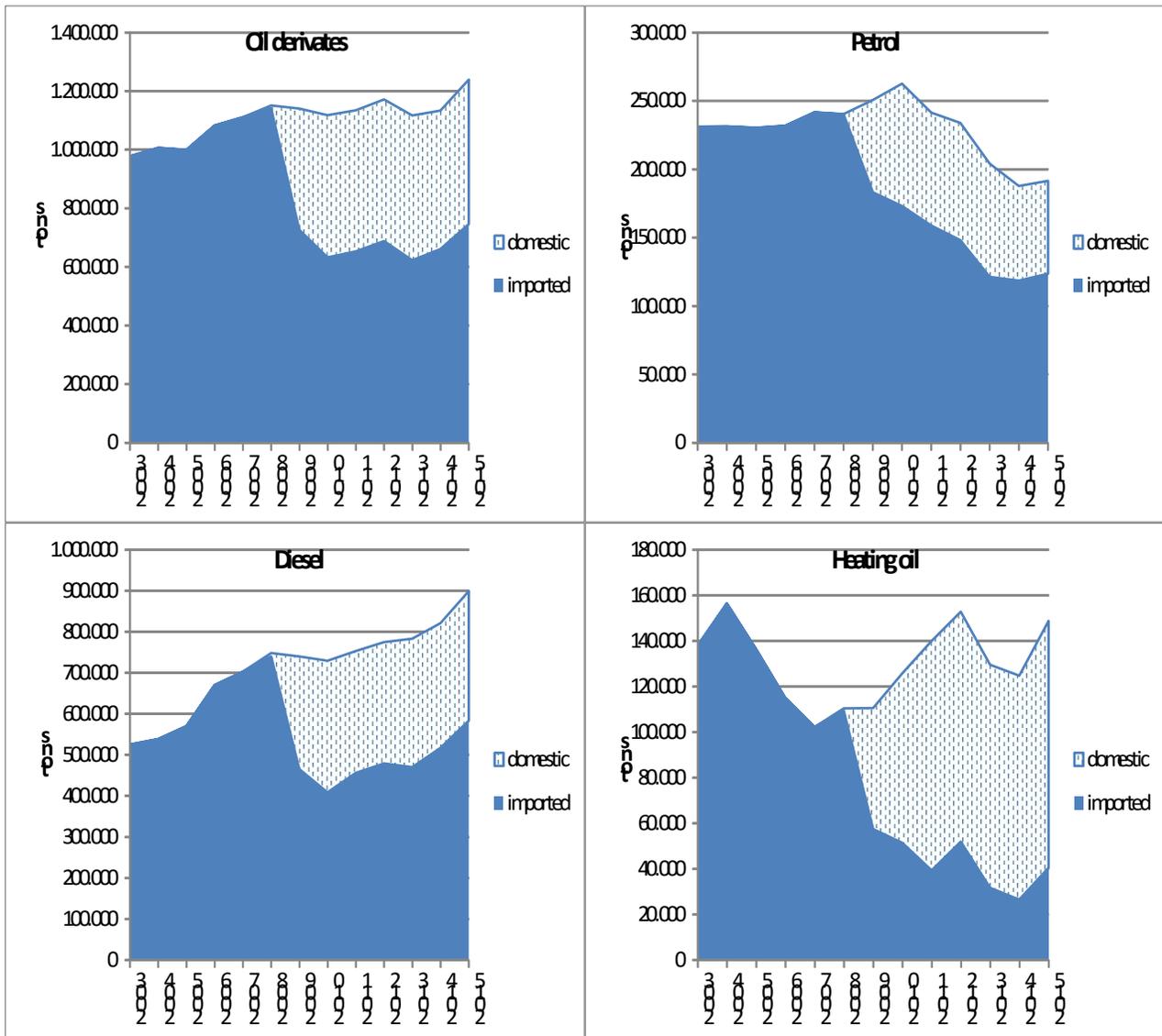
- Retail prices for derivatives in the country have dramatically dropped reflecting the fall in oil prices in the world market which affected the growth of consumption in the country;

¹ Source of data on the quantity of imported derivatives for the period 2003-2005 is the Foreign Trade Chamber of B&H, for the remaining years it is the ITA.

- Consumption is further generated from the outside (cross-border consumption and transit traffic), due to low retail derivative prices, as a result of the lowest rates of VAT and excise duties in relation to the environment and EU;
- Additional supplies of derivatives were created in the event of price increase in the market.

The growth trend of taxable amounts of derivatives in B&H continued in 2016 as well. In the first quarter growth of 13,8% was recorded, where the amount of domestic derivatives were at the level of the first quarter of 2015 while the quantities of imported derivatives increased by even 21,6%. In addition to these reasons it can be assumed that the enhanced import of derivatives in the first quarter of this year is also the result of the announcement of changes to the Law on Excise Duties which should bring an increase in excise duties on oil derivatives.

Chart 1



Due to the heterogeneous structure of the oil derivatives market it is necessary to analyze trends by segments. Chart 2 indicates strong annual fluctuations. In the period 2004-2008 there was a growth in the market of diesel and gasoline while the market of heating oil was in significant

decline although the gap in taxation between heating oil and diesel remained the same as before the reform of indirect taxes. It can be explained by the effect of the establishment of the ITA and uniform system of collection and control in terms of controlling the use of heating oil to power motor vehicles. In the period 2009-2012 it was again recorded strong growth in the heating oil market at the expense of the diesel market. It can be assumed that this was the response of consumers to the introduction of an earmarked road tax. The introduction of the earmarked road tax has significantly increased the gap in taxation between diesel and heating oil, which was an incentive for higher consumption of heating oil to power vehicles. Consumption of heating oil has escalated in 2012, when it recorded a growth of 16,8%. Applying control measures of the ITA and the Entities there is already in 2013 a trend of stabilization and gradual growth in the quantity of diesel. In 2015 there was an increase in all types of derivatives. The quantities of diesel increased by 9,6% while the quantities of gasoline increased by 1,9%. Consumption of heating oil has again escalated and recorded a growth of 19,3%.

Chart 2

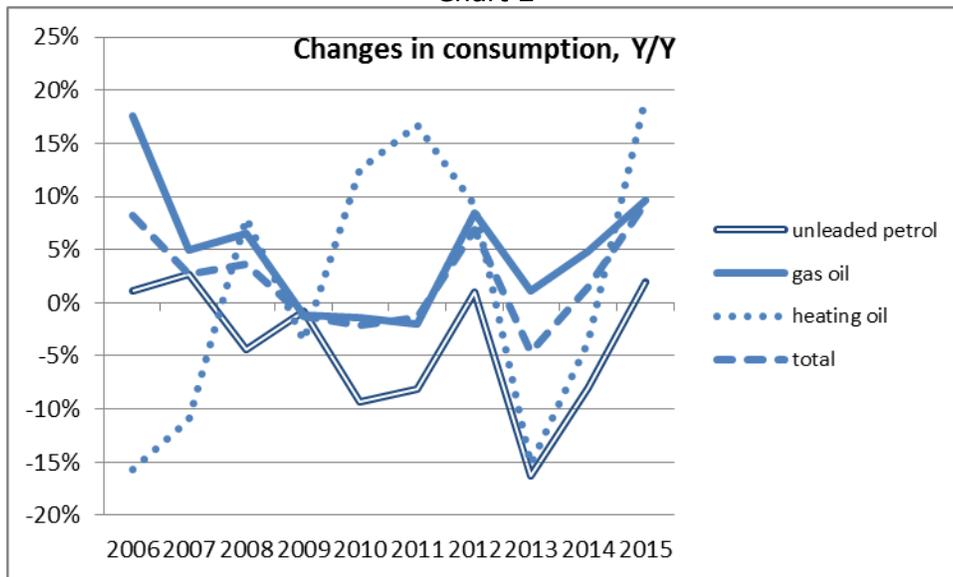
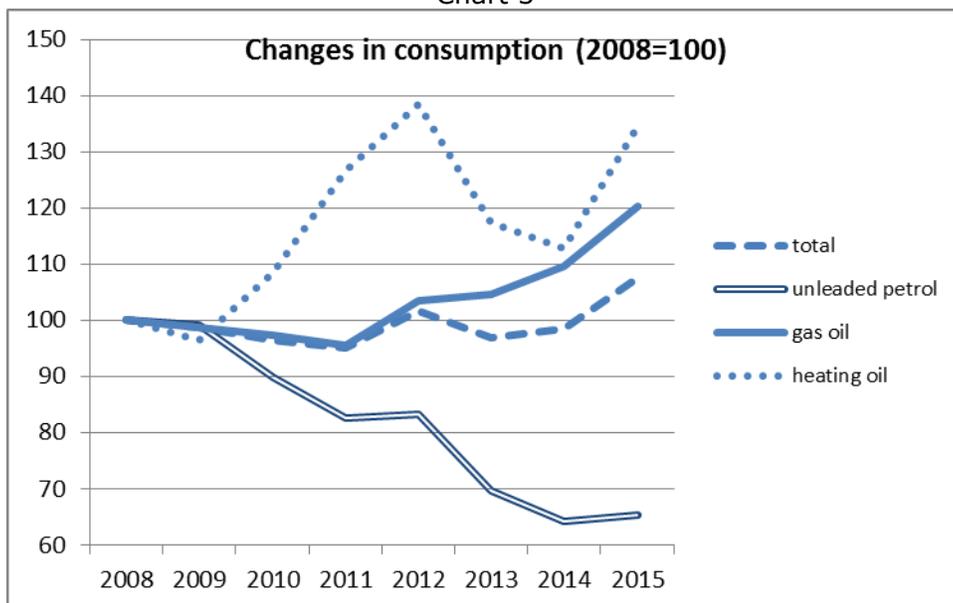


Chart 3



In the first quarter of 2016 trends from 2015 continued. Compared to the first quarter of 2015 quantities of diesel increased by 13,6% and heating oil by 13,3%. There has been a strong market recovery of gasoline of 10,6%, however, it is still within 2/3 of the market in 2008.

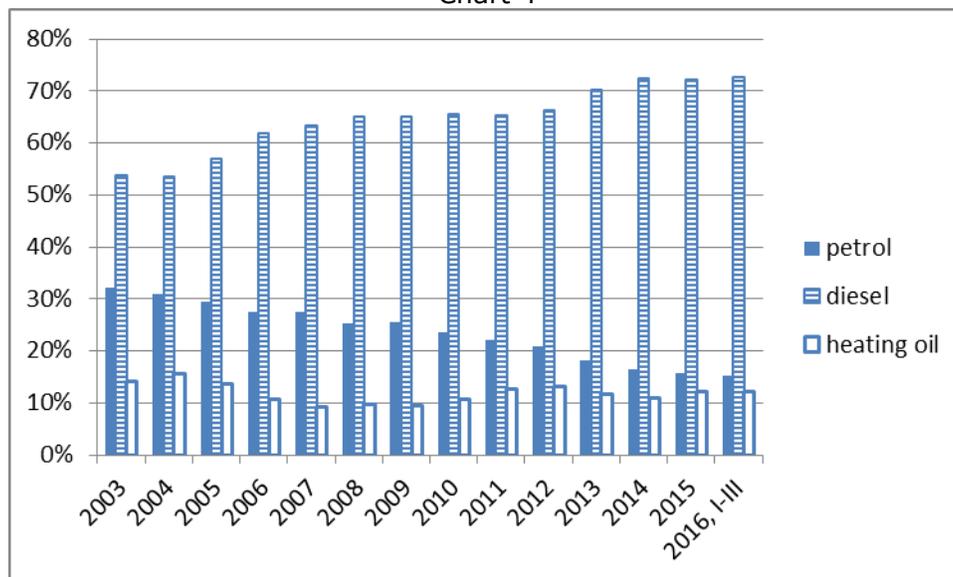
Chart 3 shows long-term trends in derivatives market, starting from the base year 2008. This year has been chosen for comparison for two reasons. First, it is the pre-crisis year which recorded the growth in economy, income and government spending, as the reflection of economic growth and budget surpluses from 2006 and 2007. Secondly, this was the last year in which the excise policy adopted at the end of 2004 was applied. Already by the mid of the following year an earmarked road tax is introduced which has significantly disrupted the structure of the derivatives market, creating an incentive for tax evasion by substituting diesel with heating oil.

Chart 3 indicates the long-term downward trend in the amount of gasoline. The reasons may be higher gasoline prices, higher taxes, higher spending and tendency of citizens and government to procure cars on diesel. Gasoline market in 2015 is only 65% of the market from 2008.

Trends in the market of diesel show decline by 2012 as a result of the crisis, the fall of the economy, income and budget deficits. Since 2013 there is a steady growth of the market, which in 2015 by 20% exceeds the market of diesel in 2008.

There has been strong growth in the segment of heating oil to the maximum in 2012, when the market grew by 40% compared to the base year 2008, then decline after the intervention of the ITA and Entities, and then again strong growth. In 2015 the segment of heating oil was higher by 35% than in 2008.

Chart 4

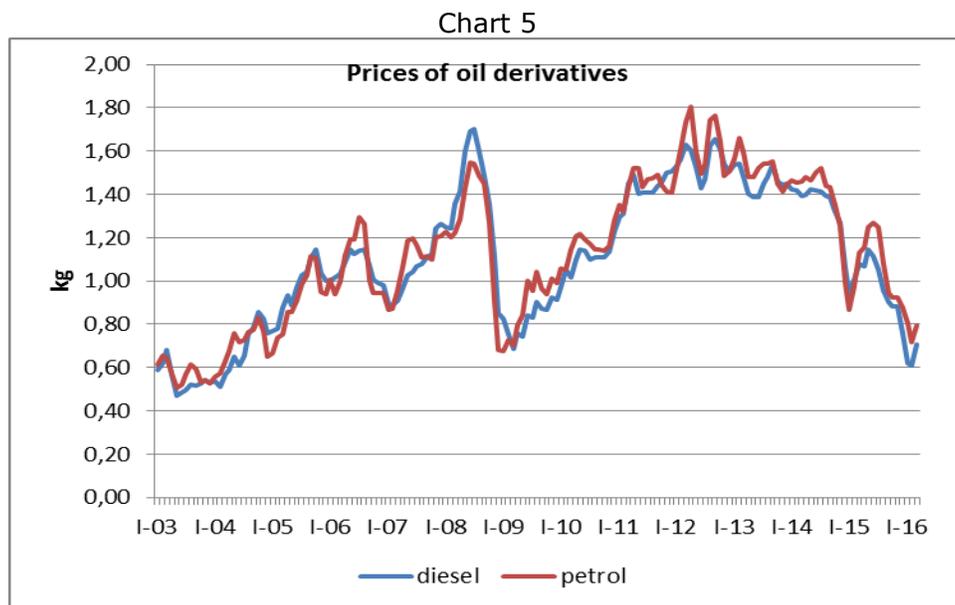


Divergent trends in the market of derivatives led to the changes in the market structure. In the past 13 years there have been dramatic changes in the market structures. At the beginning of the period (2003-2004) the share of diesel is exceeded only half of the market and in 2015 it reached the share of 73% and became the dominant type of oil derivatives in B&H. On the other hand, the share of gasoline, which accounted for almost 1/3 of the market, is now halved. Such dramatic changes have significantly altered the structure of the car market in B&H and thus paved the future direction of this industry. The smallest proportion of heating oil of 9,2% was recorded in

2007 and a maximum of 15,2% in 2004. In the last five years the share has been stabilized between 11% and 13%. Similar trends continued in the first quarter of 2016 as well (Chart 4).

Price trends of oil/derivatives in the world market and then also in the domestic one had varying impact on the consumption of oil derivatives in B&H. From this it can be concluded that other factors determinate the consumption as well. Two periods can be indicated by observing the trend in oil prices at the border. In the period 2003-2008 the prices of derivatives were increasing continuously reaching their maximum in July 2008 (Chart 5). The global economic crisis has brought a drastic fall in prices of derivatives in the third quarter of 2008. Since the end of 2010 prices began again to grow gradually reaching the maximum in September 2012. Since then prices fall slowly, but by December 2014 prices fell drastically. Thus the average price of imported diesel at the border in 2015 was at the level of the average price from 2005.

Diesel and gasoline prices have had a similar trend. Although gasoline prices were generally higher than the prices of diesel, Chart 5 shows that the oscillations of gasoline prices have often been sharper. The average price of imported unleaded gasoline at the border in 2015 was at the level of the average price from 2006.



Oil derivatives should be price elastic goods. They are not local goods or essential goods, luxury or monopoly goods in order to demand for them would be price inelastic. Movements of imported quantities of unleaded gasoline and its average price of gasoline in the moment of the import confirm the said statement (Chart 6).

However, the relation between prices and quantities of diesel shows inconsistency with elastic demand of gasoline (Chart 7). Divergences between movements of prices and movements of quantities of diesel are presented in almost the entire period of observation. The price growth in the period 2004-2008 has been accompanied by the increase in the amount. A drastic price drop in the first years of the crisis has brought only a slight decrease in the amount. Strong price growth in 2010 and 2011 has had a similar effect. Surprisingly, the rise in prices in 2012 was accompanied by an increase of imported quantities. Only since 2013, an increase in quantities of imported diesel is resulted by the reduction in prices.

Chart 6

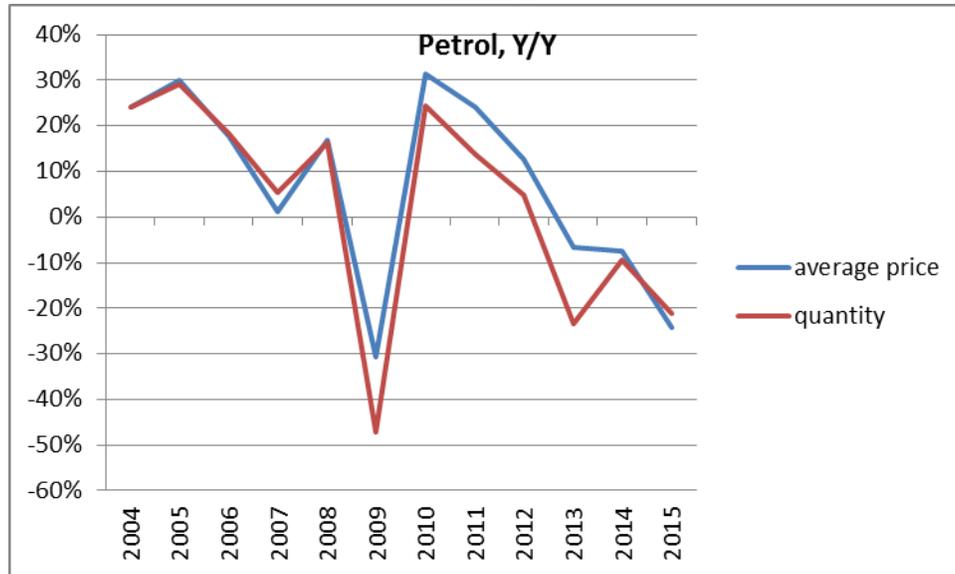
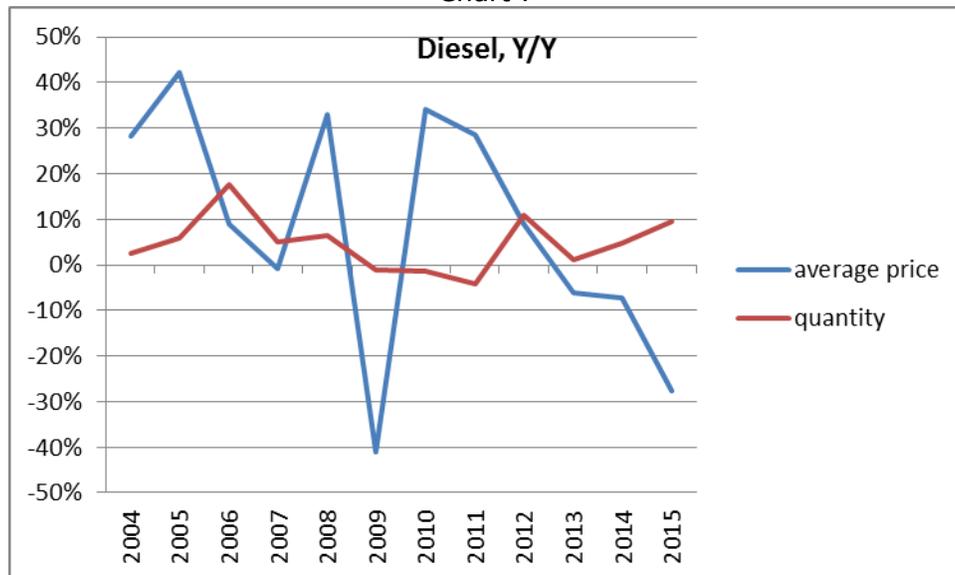


Chart 7



It can be concluded that the consumption of diesel is inelastic and consumption of gasoline is elastic. Reasons for inelasticity of diesel can be strong preferences of citizens in favor of diesel consumption due to lower prices of diesel compared to gasoline, less consumption per kilometer but also the preferences of citizens and institutions towards certain brands of diesel cars. In addition, a powerful generator of diesel consumption is industry, whose consumption is more stable because it is a necessary input for the production and operation, in relation to the consumption of the population which is under the strong action of the movement of income. On the other hand, the elasticity of gasoline is a result of its use mainly by citizens, who in conditions of limited incomes adjusted consumption depending on price changes.

TRENDS IN COLLECTION OF REVENUES FROM TAXES ON DERIVATIVES

Although excise rates on derivatives remained unchanged for many years, growth in excise revenues was achieved thanks to the increase in derivative consumption. The gradual increase in excise revenues has been stopped by the emergence of the global economic crisis. Already in 2010 excise revenues have reached pre-crisis level, but then in the next three years there were in the negative growth zone. For the analysis opposite movements of consumption and revenues in the period 2010-2012 were interesting (Chart 8). Strong growth in derivative consumption in 2015 brought the growth in excise revenues of 9,4% in relation to 2014 and compared to the former maximum of 2010, growth was 6,1%. When the Refinery started with its work in 2009 about 40% of revenue from excise duties is paid in the country (Chart 9). In the first quarter of 2016 a trend of positive growth in excise revenues of 8,4% continued. Thereto 14,5% more excise duties on the import of derivative was collected than in the first quarter of 2015 while domestic excise duties 1,5% less then the last year.

Chart 8

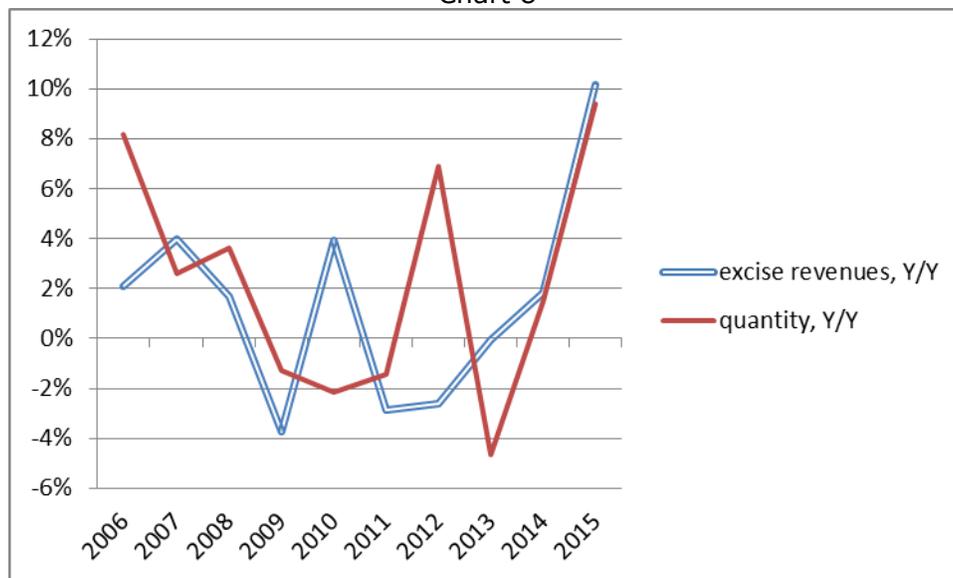
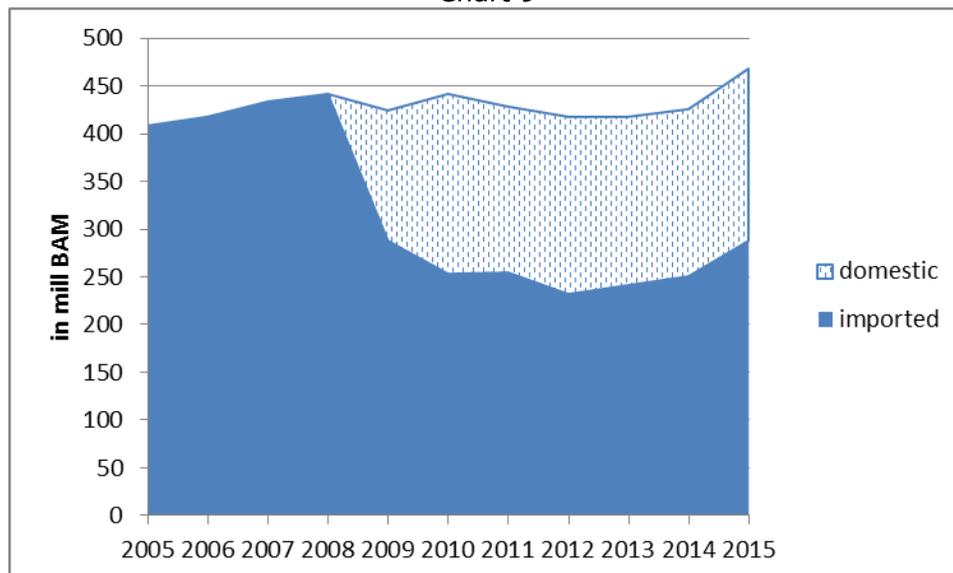
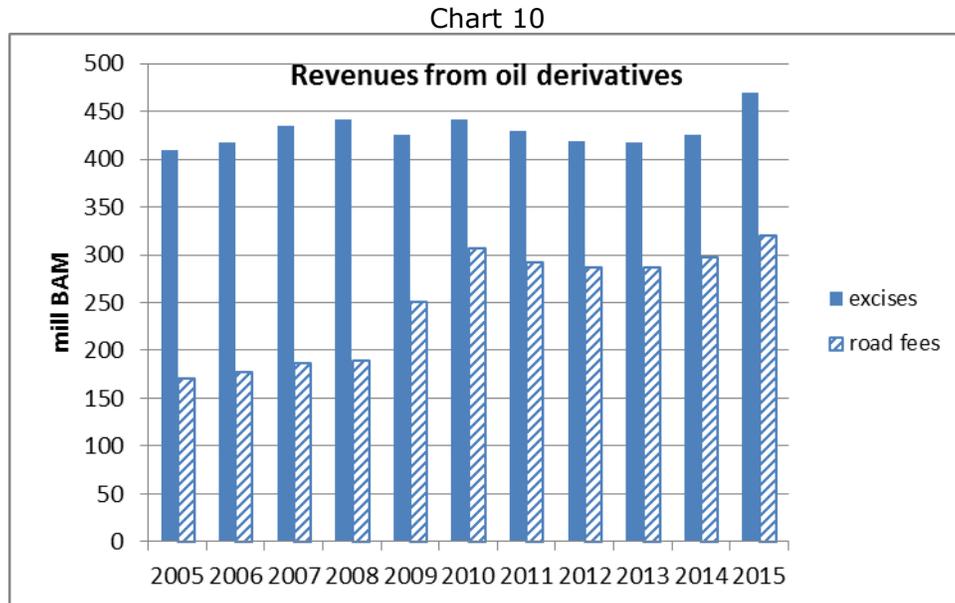


Chart 9



Revenues from road taxes generally follow the trend of revenues from excise duties, except in 2009 when there was an enormous growth in revenues from road taxes due to the introduction of an earmarked road tax in the middle of the year (Chart 10). There are several reasons for the differences in the growth rate of revenues from excise and road taxes.



Discrepancy factor of the collection of excise and road taxes is the scope of releases for the mines, power-plants and railways. In 2015, losses in road taxes based on releases to mentioned entities amounted to 14,6 million BAM.

Collection of revenues from road taxes depends on the structure of derivative consumption. Revenue growth is affected by the growth in diesel and gasoline consumption. Since the road tax is not paid on heating oil any substitution of diesel with heating oil to power vehicles is resulted in illegal tax evasion and losses of revenues from road taxes.

Losses of revenues from road taxes can be roughly estimated starting from the base year of 2008. The mentioned year is taken as a reference for the level of consumption of heating oil because it was a pre-crisis year, and preceded to the year when the earmarked road tax for highways was introduced. The calculation of differences in quantities of heating oil imported and placed on the market in the period 2009-2015 in relation to the amount from the reference year 2008 indicates the total revenue loss of approximately 48 million BAM from road taxes. Actual losses are probably even greater. In fact, more favorable tax treatment of heating oil is taken from the Entity tax systems. Then it also created an incentive to substitute diesel with heating oil producing tax evasion but on a smaller scale than today because the difference in the tax burden in liter of heating oil until 1st of July 2009 amounted to 0,15 BAM/l + VAT. Following the introduction of an earmarked road tax this difference amounts to 0,25 BAM/l +VAT.

INSTEAD OF CONCLUSION

Bearing in mind the rough estimates of past losses in revenues from road taxes due to the substitution of diesel by consumption of heating oil it can be concluded that the introduction of the earmarked road tax aggravated tax evasion on the derivatives market. Amendments to the Law on Excise Duties, which are in the process, will boost illegal substitution of diesel by heating oil. Although it does not increase the tax burden gap between heating oil and diesel, the growth in retail prices of derivatives due to the rising excises enhances incentives for substitution. The price growth on the world oil market which will have repercussions on retail prices of derivatives creates an additional incentive for the diesel substitution. All this will lead to the strengthening of tax evasion, which would reduce the expected revenue from road taxes².

The most effective model for financing roads and highways would involve a mix of tax and budgetary instruments: application of uniform excise rates on all oil derivatives, without differentiation based on the type of derivative or its use, and financing the road maintenance and certain projects of highways construction by targeted transfers from the budget of the government to the Directorates of roads/highways.

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.

**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 1st January 2016

² More on the effects of amendments to the Law on Excise Duties and risks to the realization of projections in the program scenario projections of indirect tax revenues, OMA Bulletin No. 130-131, May/June 2016, www.oma.uino.gov.ba.

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

<i>(in million BAM)</i>	I	II	III	IV	Total
Revenue	493,3	543,2	604,9	621,7	2.263,0
Taxes	409,8	440,1	491,1	494,2	1.835,2
Direct taxes	20,7	30,0	58,7	54,4	163,8
Taxes on income, profits and	20,0	29,0	57,5	53,2	159,7
Taxes on property	0,7	1,0	1,2	1,2	4,1
Indirect taxes (net)	389,0	410,1	432,4	439,8	1.671,3
VAT	236,5	265,9	268,9	275,0	1.046,2
Excises	118,1	98,3	110,6	117,0	443,9
Road fee	21,3	24,6	28,0	26,3	100,2
Customs	12,1	20,0	23,4	19,8	75,2
Other indirect taxes	1,1	1,4	1,6	1,8	5,9
Other taxes	0,0	0,0	0,0	0,0	0,1
Social security contributions	49,3	61,9	62,6	63,6	237,5
Grants	1,3	0,5	2,9	1,3	5,9
Foreign grants	0,2	0,3	2,8	1,1	4,3
Transfers	1,1	0,2	0,1	0,2	1,6
Other (non-tax) revenue	32,9	40,7	48,3	62,6	184,5
Expenditure	487,4	510,4	542,5	601,0	2.141,3
Expense	481,3	507,9	539,0	589,9	2.118,0
Compensation of employees	136,2	131,6	135,7	129,9	533,4
Use of goods and services	14,7	19,5	30,4	22,4	87,0
Social benefits	132,5	138,3	136,7	182,1	589,6
Interest	5,5	13,8	18,5	19,7	57,5
Interest payments to non-	3,3	9,9	11,4	13,1	37,7
Interest payments to residents	2,2	3,9	7,2	6,6	19,8
Subsidies	0,1	2,8	9,0	9,7	21,6
Grants, transfers (incl. transfers from	188,6	197,9	197,4	221,0	804,9
Other expense	3,7	4,0	11,2	5,1	24,0
Net acquisition of nonfinancial assets	6,1	2,6	3,5	11,2	23,3
Acquisition of nonfinancial assets	6,5	3,2	6,5	11,9	28,1
Disposal of nonfinancial assets	0,4	0,7	3,0	0,8	4,8
Gross/Net operating balance (revenue minus expense)	12,0	35,3	65,9	31,8	145,0
Net lending /borrowing (revenue minus expenditures)	5,9	32,7	62,4	20,6	121,7

Table 1.

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