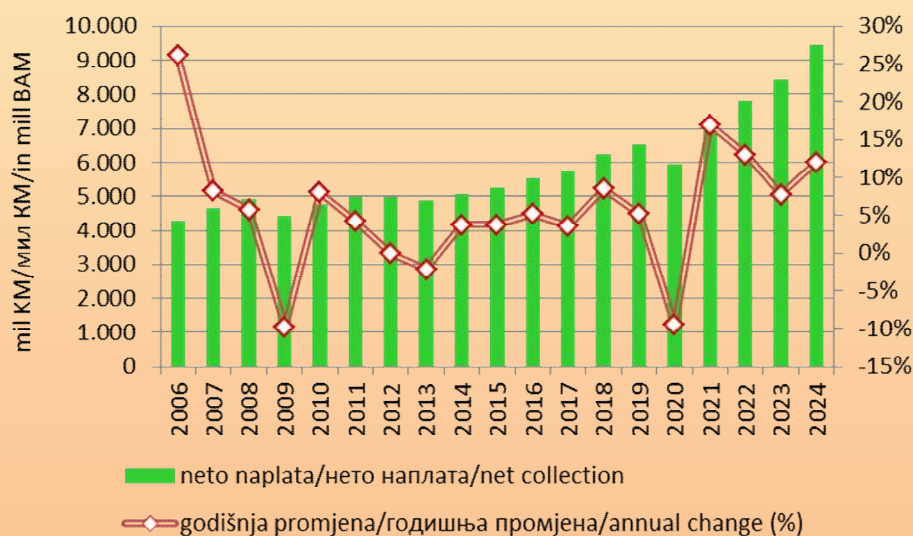




Macroeconomic Unit of the Governing Board of the Indirect Taxation Authority

# ОМЈА Билтен



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## With this issue

Indirect tax refund payments in 2024 amounted to 2.092 billion KM, which was 114 million BAM less than in 2023. Reduced refund payments had a positive effect on the net collection, so that in 2024, 1.015 billion more indirect tax revenues were collected than in 2023. It can be concluded that the reduction in refund payments brought as much as 11% of the effects of net indirect tax collection. Indirect tax refunds mostly (98%) come from VAT refunds. Unlike refunds based on other types of indirect taxes, which are sporadic or introduced as reliefs, VAT refunds are an important component of the VAT concept that ensures its neutrality in relation to the economic position of taxpayers. A specific feature of the VAT system in B&H are refunds based on international projects, which account for 5.2% of total refunds. The largest part of VAT refunds comes from exports, imports and investments, where it is not possible to offset input VAT with output VAT during the tax period.

Chart 1

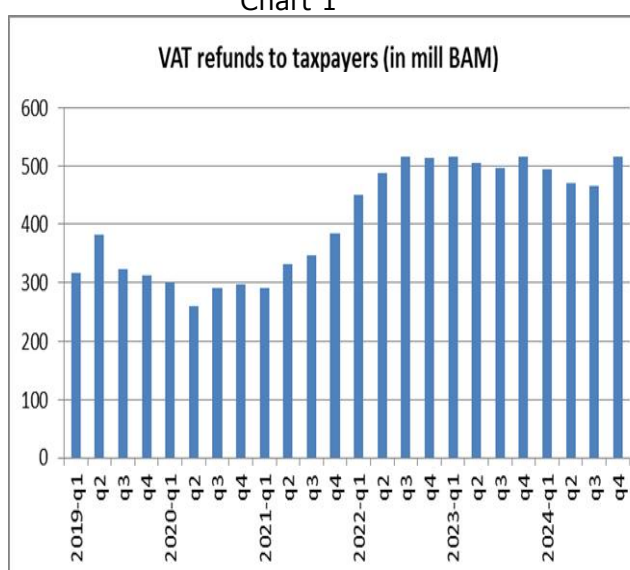
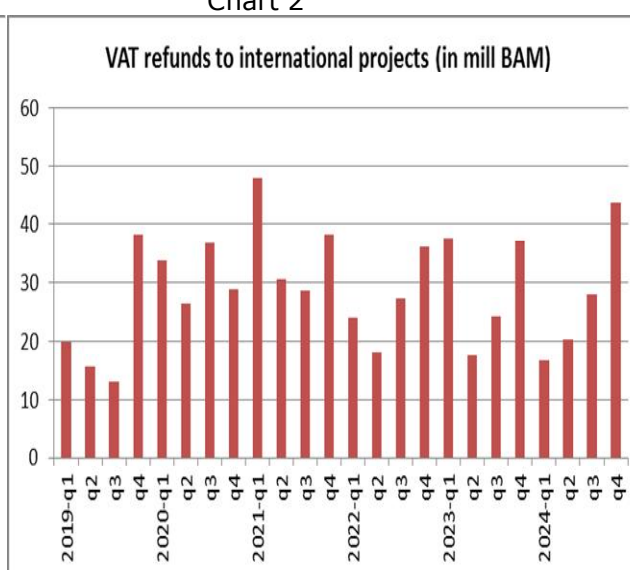


Chart 2



The decrease in refunds in 2024 mostly related to VAT refunds to taxpayers (-86 million BAM), while VAT refunds based on international projects were 8.1 million BAM lower. The main reasons for the lower VAT refund payments were the decline in imports, exports, investments, and internationally financed projects. However, an overview of quarterly refund payments indicates the fact that, despite the decline in imports and exports, VAT refund payments to taxpayers (Chart 1) and to international projects (Chart 2), were significantly higher than before the pandemic and the global crises that have affected the B&H economy in the last three years.

Dinka Antić, PhD  
Head of Unit

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## Collection of revenues from indirect taxes in 2024

(Prepared by: Aleksandra Regoje, expert advisor - macroeconomist)

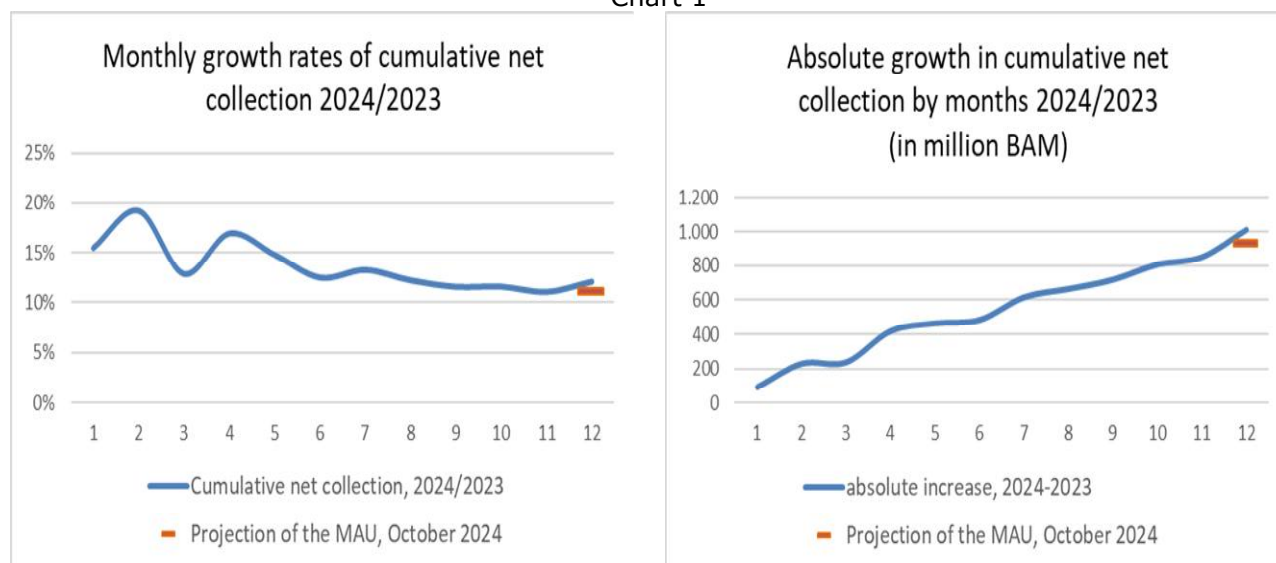
*At the time of preparing this article, data on the total gross and net collection of indirect taxes on the Single Account of the Indirect Taxation Authority (ITA SA) in 2024 was available, while the report on revenue collection by types of revenue was not available. Therefore, in this issue, we publish a brief overview of the collection of indirect taxes in 2024 compared to the previous year and long-term trends. After the final report by types of revenue on the ITA SA is available, in the next issue of the MAU Bulletin we will publish a detailed analysis of the collection of indirect taxes in 2024, with an overview of collection by revenue types.*

### Collection in 2024, comparison with the previous year

Gross collection of indirect tax revenues amounted to 11,541.3 million BAM, which is 900.8 million BAM or 8.5% more than gross collection in the previous year. Refund payments amounted to 2,091.9 million BAM, which was 114.1 million BAM or 5.2% lower than in 2023. Finally, net collection of indirect taxes amounted to 9,449.4 million BAM. The absolute increase in net revenues in 2024 compared to 2023 amounted to 1,014.9 million BAM, while the relative growth was 12%.

Compared to the Unit's projections from October 2024, net collection of indirect taxes is higher by 83.6 million BAM (Chart 1). It can be concluded that the Unit's October projections were implemented by 100.89%.

Chart 1



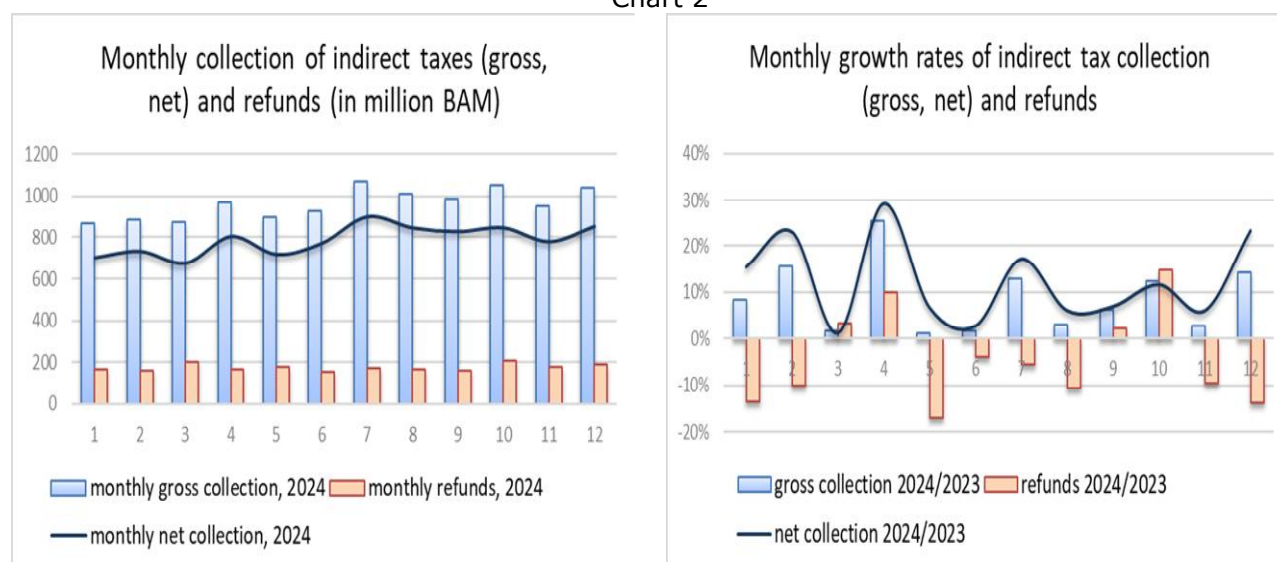
Source: Indirect Tax Administration of B&H, presentation of the MAU

### Monthly collection of indirect taxes and refunds

Monthly gross collection of indirect taxes<sup>1</sup> ranged from 869.1 million BAM (January) to 1,073.2 million BAM (July). Compared to the previous year, monthly gross collection was in a positive growth zone throughout the year (see Chart 2, blue bars). Gross collection growth rates compared to 2023 ranged from 1% (May) to 25.4% (April).

Monthly amounts of indirect tax refunds ranged from 153.5 million BAM (June) to 204.5 million BAM (October). Unlike gross collection, the line of monthly refund growth rates compared to the previous year alternately crossed from one zone to another (positive and negative). Indirect tax refund growth rates in 2024 compared to the previous year were negative in January, February, from May to August, and in November and December. In all other months of the year, they were positive (see Chart 2, right, orange bars).

Chart 2

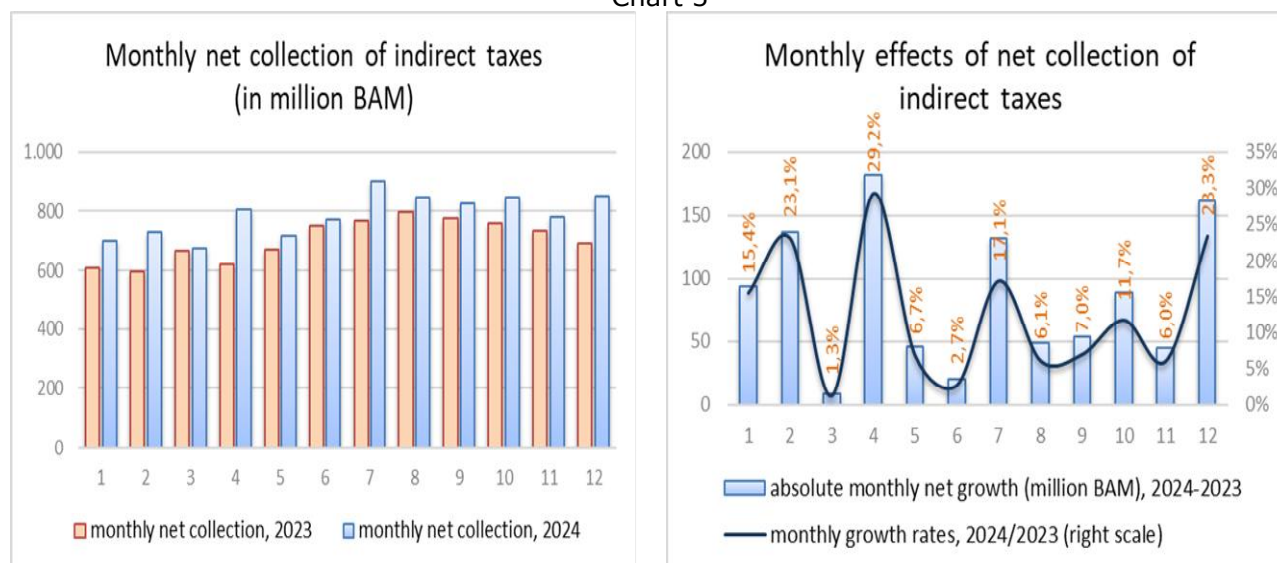


Source: Indirect Tax Administration of B&H, presentation of the MAU

Throughout 2024, monthly amounts of the net indirect tax collection (Chart 3, left, blue bars) were higher than in the previous year. They ranged from 674.2 million BAM (March) to 900.1 million BAM (July). Growth rates (Chart 3, right, blue line) ranged from +1.3% (March) to a high of +29.2% (April). Observed in absolute terms, the growth in monthly net indirect tax collections ranged from +8.4 million BAM in March to a high of +181.7 million BAM in April.

<sup>1</sup> The monthly gross indirect tax collections in this article were calculated from the ITA's cumulative collection reports, as the difference between the revenues for a given month (m) and the revenues of the previous month (m-1). The same principle is used to calculate the monthly net collections and refunds.

Chart 3

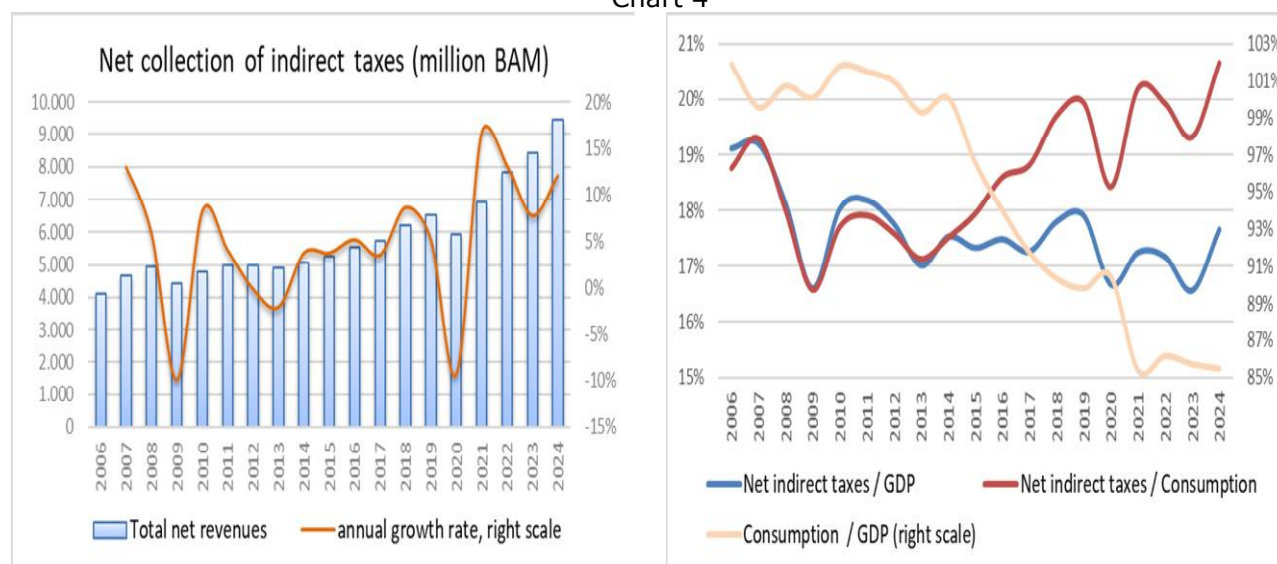


Source: Indirect Tax Administration of B&amp;H, presentation of the MAU

### Analysis of collection in 2024 with regard to long-term trends

In 2024, a record amount of indirect taxes was collected since the establishment of the ITA. Compared to the year of VAT introduction (2006), the net collection has more than doubled (an increase of 129.2%). Relatively high revenue growth rates were achieved in the last four years (Chart 4). Thus, compared to the pre-crisis year 2019, revenue growth of a high 44.4% was achieved in 2024.

Chart 4



Source: Indirect Tax Administration of B&amp;H, presentation of the MAU

If we take into account the projections of macroeconomic indicators for 2024 of the Directorate for Economic Planning of B&H (DEP) prepared in September 2024,<sup>2</sup> we can observe the trends in the share of net indirect tax collection in GDP and consumption. The estimated share of net indirect tax collection in GDP increased by 1.1 p.p., from 16.6% in 2023 to 17.7% in 2024. The estimated growth in the share of net indirect taxes in total consumption was 1.34 p.p. (from 19.3% in 2023 to 20.7% in 2024). Once the final report by revenue type and official data from the Agency for Statistics of B&H (BHAS) on macroeconomic indicators are available, it will be possible to calculate the official levels of the aforementioned shares, and to estimate how much they were influenced by the growth in revenue collection efficiency, and how much by the effects of policy change measures in 2024.

The lower shares of indirect taxes in GDP in recent years compared to the initial years after the establishment of the ITA can be explained by the decline in the share of consumption (which represents the base of indirect taxes) in GDP in the past period.<sup>3</sup> The share of indirect taxes in GDP and consumption was at approximately the same level until 2015, when the share of consumption in GDP amounted around a high 100%. Since 2015, there has been a downward trend in the share of consumption in GDP, while, according to projections, in 2024 it amounted to 85,5%. With the decline in the share of consumption in GDP, since 2015, the line of the share of indirect taxes in GDP has been significantly below the line of its share in consumption. Based on the DEP's projections of macroeconomic indicators from September 2024, it is estimated that in 2024, the highest share of indirect taxes in consumption was achieved (20,7%) since the establishment of the ITA.

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<sup>2</sup> At the time of preparing this article, the official data from the Agency for Statistics of B&H until 2023 were available (BHAS, Gross Domestic Product for B&H 2023, expenditure approach - first results; September 30, 2024)

<sup>3</sup> The share of indirect taxes in GDP can be broken down into the product of: (1) share of revenues from indirect taxes in total consumption and (2) share of total consumption in GDP.



## Analysis of the allocation of revenues from indirect taxes for the 2024

(Author: Mirjana Popović, Expert Advisor - Macroeconomists)

### Summary

The allocation of revenues from indirect taxes in Bosnia and Herzegovina (hereinafter: BiH) represents one of the key economic issues that has a direct impact on the financial stability and functioning of all levels of government. The system of indirect taxes ensures a significant part of the budget revenues of the state level, entities level and Brčko District. Revenues from these taxes are collected in the Single Account of the Indirect Taxation Authority (hereinafter: ITA) and are allocated according to coefficients for allocation based on final consumption.

Analysis of the allocation of revenues from indirect taxes for the period 2021-2024 provides insight into trends and changes in revenues and their use at different levels of government. This period was marked by the economic consequences of the Covid-19 pandemic, global disruptions in supply, inflationary pressures, which in a certain way affected the process of allocation of these revenues.

The goal of this analysis is to look at the dynamics of revenue collection and allocation, to determine the factors that influenced these processes, and to assess their impact on the economic stability and sustainability of public finances in BiH. The analysis provides a basis for understanding the financial situation in BiH in the specified period, identification of key problems and possible improvements within the system of indirect taxation.

This analysis is a continuation of the analysis published in previous issues of the Department's bulletin<sup>4</sup> with a focus on the allocation system according to the vertical structure, and in accordance with the prescribed methodology and allocation procedure. The analysis shows the allocation of revenues from indirect taxes in BiH for the period 2021-2024 on an annual basis<sup>5</sup> as well as the allocation of highway toll revenue for the same period.

## 1. Allocation of revenues from indirect taxes for the period 2021-2024

### 1.1. Allocation of gross revenues to users

Gross revenues from indirect taxes are total revenues collected on a single account<sup>6</sup> intended for refunds that have priority during allocation, as well as revenues intended for allocation to the institutions of BiH, the Federation of BiH, the Republic of Srpska and Brčko District. The total amount of funds intended for allocation to the entities and Brčko District includes the amount intended for the financing of external debt.

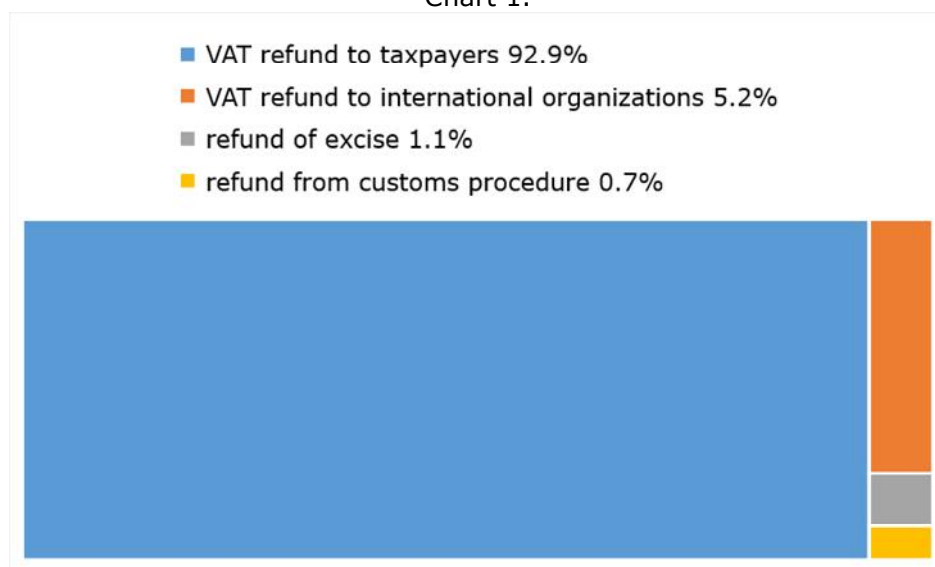
Chart one shows the participation in the refund structure in 2024.

<sup>4</sup> More about the system of allocation of indirect taxes in Bosnia and Herzegovina in: Popović, M. (2019). "Analysis of the allocation of revenues from indirect taxes for the period 2006-2018 (trends and structure)". MAU bulletin no. 168/169

<sup>5</sup> Earlier analyses of the allocation of revenues from indirect taxes, and the latest Analysis of the allocation of revenues from indirect taxes for the 2022 published in MAU bulletin No 211/212 show the annual allocation of these revenues for the period 2006-2022 which included the occurrence of several shocks in certain years and their impact on indirect tax revenues has been analyzed.

<sup>6</sup> VAT, customs, excise, toll 0.15 BAM

Chart 1.



Source: Data from the Indirect Taxation Authority of BiH, MAU overview

The largest allocation in the refund structure in 2024 of 98.1% refers to the total VAT refund, of which 92.9% refers to the VAT refund to taxpayers who, according to their VAT returns, are entitled to a refund, while 5.2% refers to the refund of VAT to international organizations. A significantly smaller allocation of the remaining 1.9% of the total refund refers to the refund of excise duty, refund according to decisions from the customs procedure and refund of deposits.

After the refunds have been made, the remaining amount of the total revenue collected is reduced by the amount intended for minimum reserves, whose participation in the revenues after the refund is made in 2024 is 18.9% (chart 2 and 3).

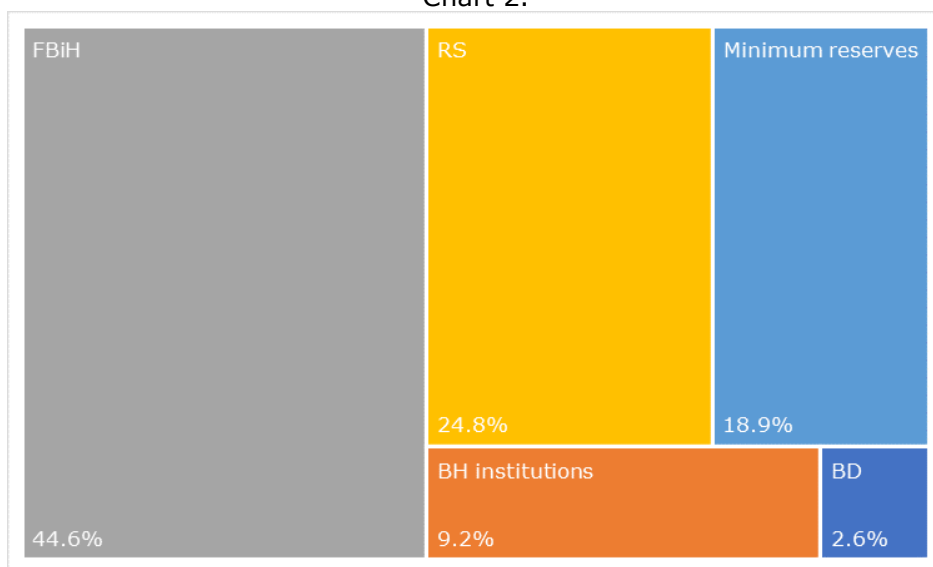
After allocating part of the revenues intended for minimum reserves, the corresponding fixed amount of revenues intended for the financing of BiH institutions is allocated and remitted, which in 2024 comprises 9.2% of the total participation in revenues from indirect taxes (chart 2 and 3).

The remaining amount after deducting the amount for minimum reserves and the amount belonging to the budget of BiH institutions represents the amount for allocation to the entities and Brčko District, which includes the amount intended for financing the external debt (chart 2).

Chart two shows the participation in the allocation of revenues to the Federation of BiH, the Republic of Srpska and Brčko District, including the amount for financing external debt, as well as the participation in the allocation of revenues for minimum reserves and financing of BiH institutions.



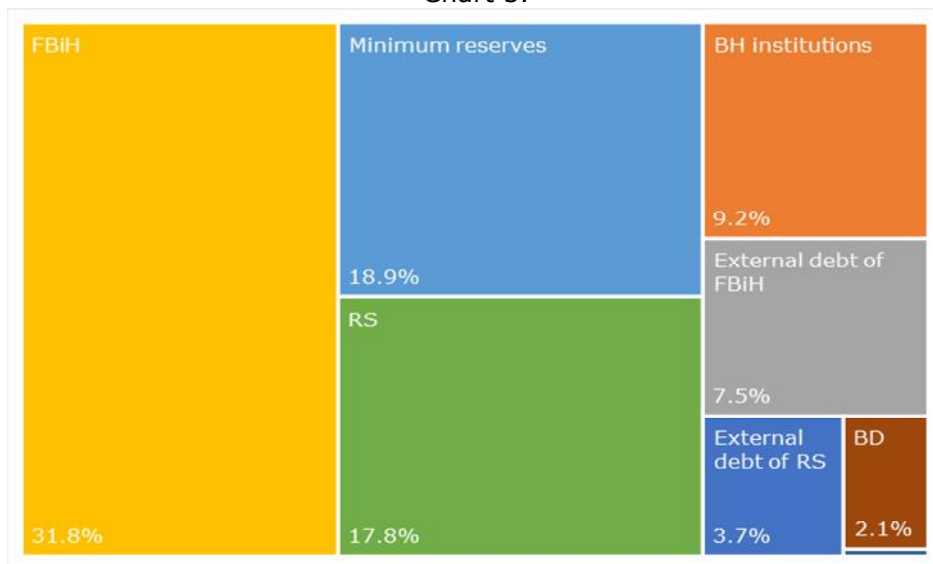
Chart 2.



Source: Data from the Indirect Taxation Authority of BiH, MAU overview

Chart three shows the participation in the allocation of revenues to the entities and Brčko District after the allocation of a part of the funds related to the financing of the external debt, the participation in the allocation of revenues intended for the financing of the external debt of the entities and Brčko District, as well as the participation in the allocation of revenues intended for minimum reserves and financing institution of Bosnia and Herzegovina.

Chart 3.



Note: ■ BD external debt 0.1%

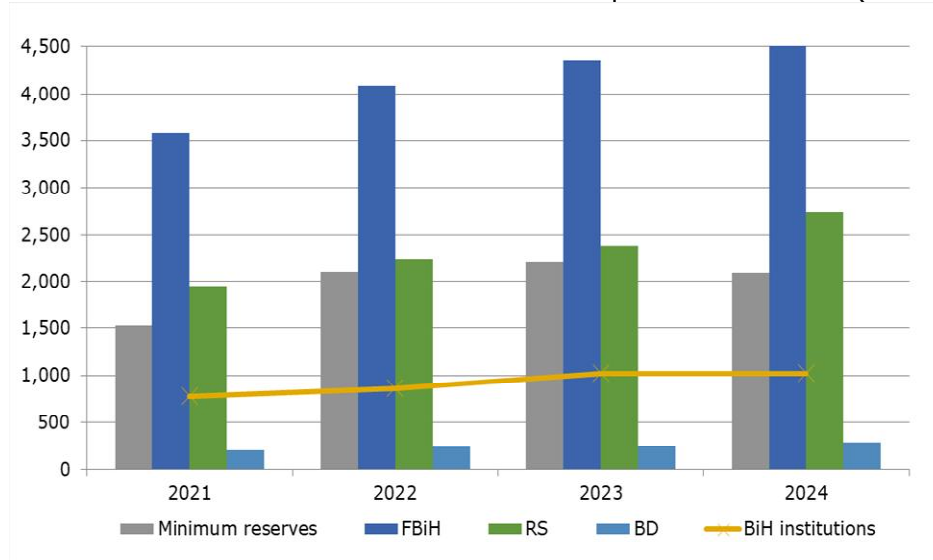
Source: Data from the Indirect Taxation Authority of BiH, MAU overview

The allocation to the entities is carried out according to pre-determined allocation coefficients at the quarterly level<sup>7</sup>, while the coefficient for allocation to Brčko District is fixed<sup>8</sup>.

<sup>7</sup> The ratio of the amount of final consumption stated in the VAT returns of taxpayers in the territory of a given entity or a given user of revenues and the amount of final consumption stated in VAT returns in the entire territory of BiH.

Chart four shows the allocation of revenues from indirect taxes for the period 2021-2024, in millions of BAM<sup>9</sup>.

Chart 4. Allocation of revenues from indirect taxes for the period 2021-2024 (in millions of BAM)



Source: Data from the Indirect Taxation Authority of BiH, MAU overview

Compared to 2023, growth in 2024 was recorded during allocation to entities (the Federation of BiH 13.5%, the Republic of Srpska 15.3%) and Brčko District 14.1%, while the amount for allocation intended for minimum reserves is smaller by 5.2%. The amount intended for the financing of BiH institutions in 2024 is the same as in the previous year<sup>10</sup>.

Table one shows the participation in the allocation of revenues from indirect taxes for the period 2021-2024.

Table 1.

in %	2021	2022	2023	2024
Minimum reserves	19.0	22.0	21.6	18.9
BiH institutions	9.7	9.1	10.0	9.2
FBiH	44.5	43.0	42.7	44.6
RS	24.3	23.5	23.3	24.8
BD	2.5	2.4	2.4	2.6
Total	100	100	100	100

Source: Data from the Indirect Taxation Authority of BiH, MAU overview

<sup>8</sup> The representative of Brčko District has the status of an observer in the Governing Board of the ITA, and does not participate in the decision-making on the allocation of revenues from indirect taxes from the Single Account by voting. The High Representative, protecting the fiscal autonomy that Brčko District had before the reform of the indirect taxation system, by decision of June 1, 2007 imposed a fixed coefficient for Brčko District for minimum of 3.55% or at least 124 million of BAM per year in absolute terms.

<sup>9</sup> The amount of gross revenue excludes revenues from dedicated tolls

<sup>10</sup> From 2023, it amounts 1,020.5 millions of BAM on an annual basis

Table two shows the difference in participation in the allocation of revenues from indirect taxes in p.p. for the 2024 compared to previous years used for the purpose of this analysis.

Table 2.

change in p.p.	Index (2024-2023)	Index (2024-2022)	Index (2024-2021)
Minimum reserves	-2.7	-3.2	-0.1
BiH institutions	-0.8	0.1	-0.5
FBiH	1.9	1.6	0.1
RS	1.5	1.3	0.5
BD	0.1	0.1	0.0

Source: Data from the Indirect Taxation Authority of BiH, MAU overview

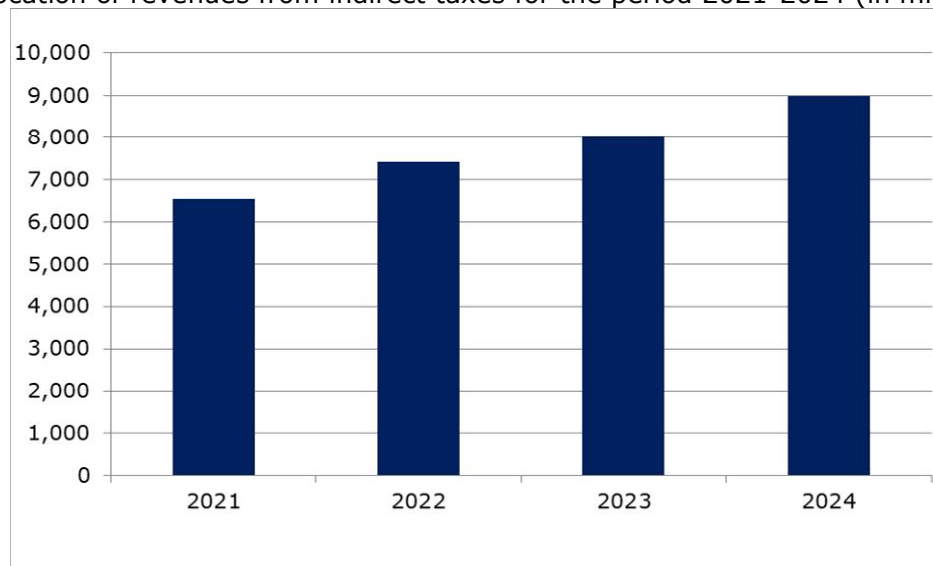
Compared to 2023, in 2024 the participation in the allocation intended for minimum reserves (-2.7 p.p.) and the participation intended for the financing of BiH institutions (-0.8 p.p.) decreased, while the participation in the allocation to the entities and Brčko District increased (the Federation of BiH 1.9 p.p., the Republic of Srpska 1.5 p.p., Brčko District 0.1 p.p.).

## 1.2. Allocation of net revenues to users

The remaining amount after the allocated part of the funds intended for minimum reserves includes the amount of net revenues from indirect taxes that is intended for allocation to the beneficiaries: BiH Institutions, the Federation of BiH, the Republic of Srpska and Brčko District<sup>11</sup>.

Chart five shows the total allocated net revenues from indirect taxes for the period 2021-2024, in millions of BAM.

Chart 5. Allocation of revenues from indirect taxes for the period 2021-2024 (in millions of BAM)



Source: Data from the Indirect Taxation Authority of BiH, MAU overview

In the observed period, net revenues from indirect taxes tend to grow, which is conditioned by a combination of various economic and fiscal factors. The most significant factors that influenced the growth of these revenues in the period 2021-2024 are the result of economic recovery after the stagnation in the economy due to the Covid-19 pandemic. From 2021, there will be a recovery of

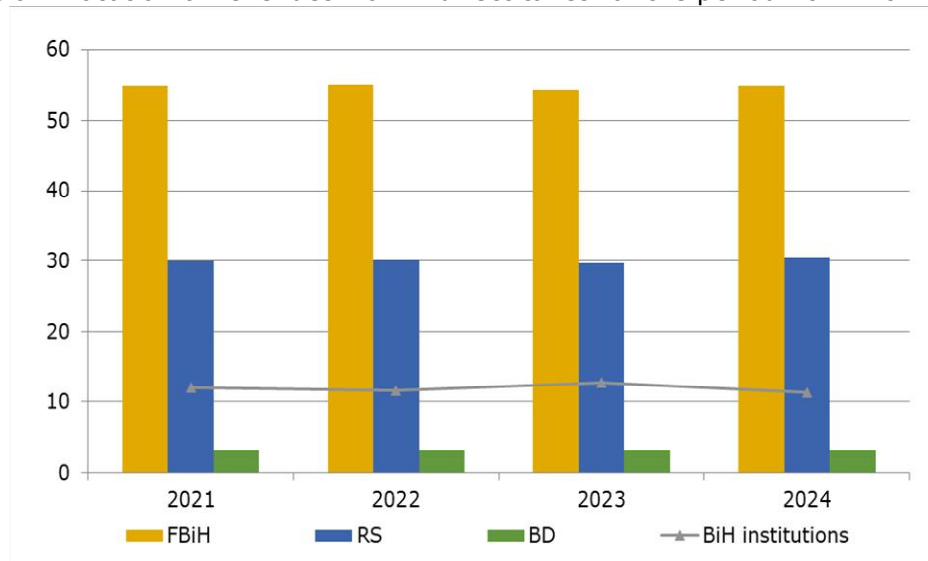
<sup>11</sup> Including external debt of entities and Brčko District

the economy, an increase in consumption, imports and production. The gradual increase in the standard of living, the growth of salaries in the public and private sectors, as well as the increase in the cost of living, led to increased consumption, which directly leads to an increase in VAT revenue. Inflation, which was present during the observed period, led to an increase in the prices of products and services. Given that VAT is calculated on the basis of price, a higher price resulted in higher tax revenues. The increased volume of imports, especially of energy and other basic products influenced the increase in revenues from customs duties, excise duties and VAT on imported goods. Digitalisation of tax collection procedures and strengthening the control reduced tax evasion by increasing revenue collection.

The growth in the number of tourists in BiH during this period also influenced the increase in consumption in the catering, retail and other services sectors, which generated more VAT revenue. However, given that this growth is partly the result of inflation and specific circumstances such as global disruptions in supply chains due to the war between Russia and Ukraine, it may be temporary and the trend in the collection and allocation of these revenues will continue to be monitored in the future. The chart shows that in 2024, the historical maximum of total net revenues from indirect taxes intended for allocation to users was collected, which is 12.3% higher than in 2023.

Chart six shows the participation in the allocation of net revenues from indirect taxes to beneficiaries: BiH institutions, the Federation of BiH, the Republic of Srpska and Brčko District<sup>12</sup>, for the period 2021-2024. The largest participation in the allocation of these revenues is held by the Federation of BiH, followed by the Republic of Srpska, the BiH institutions and Brčko District.

Chart 6. Allocation of revenues from indirect taxes for the period 2021-2024 (in %)



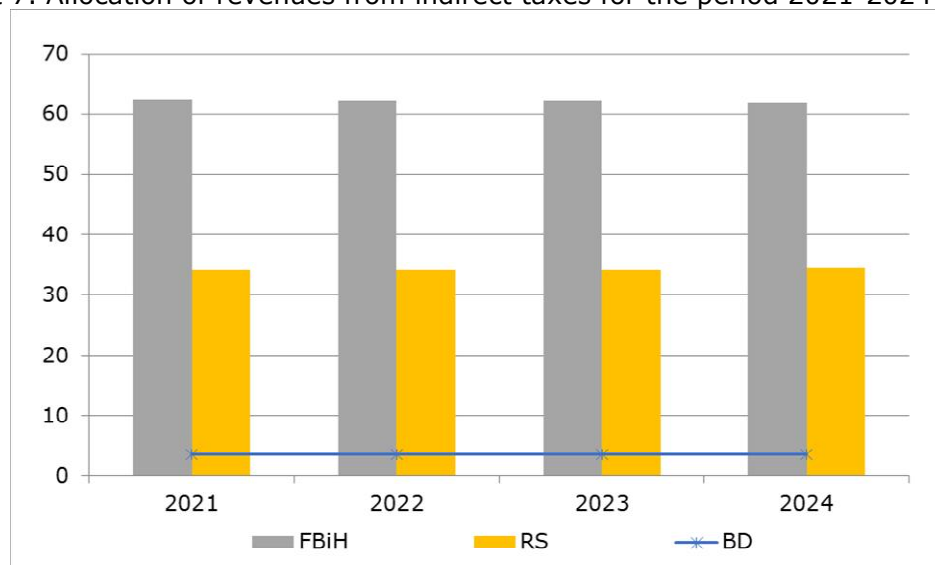
Source: Data from the Indirect Taxation Authority of BiH, MAU overview  
Source: Data from the Indirect Taxation Authority of BiH, MAU overview

Chart seven shows the participation in the allocation of net revenues from indirect taxes to the entities and Brčko District<sup>13</sup> in the period 2021-2024 after the allocation of the corresponding part to the BiH institutions.

<sup>12</sup> Including external debt of entities and Brčko District

<sup>13</sup> Including external debt of entities and Brčko District

Chart 7. Allocation of revenues from indirect taxes for the period 2021-2024 (in %)



Source: Data from the Indirect Taxation Authority of BiH, MAU overview

Entities' participation in allocation is determined on the basis of allocation coefficients based on final consumption, while Brčko District's participation is defined by a fixed allocation coefficient. In the observed period, there were no major fluctuations in the coefficients for the allocation of net revenues from indirect taxes to the entities on an annual basis. The Federation of BiH recorded the largest share in the allocation of these revenues in 2021, and the smallest share in 2024, in favor of the Republic of Srpska.

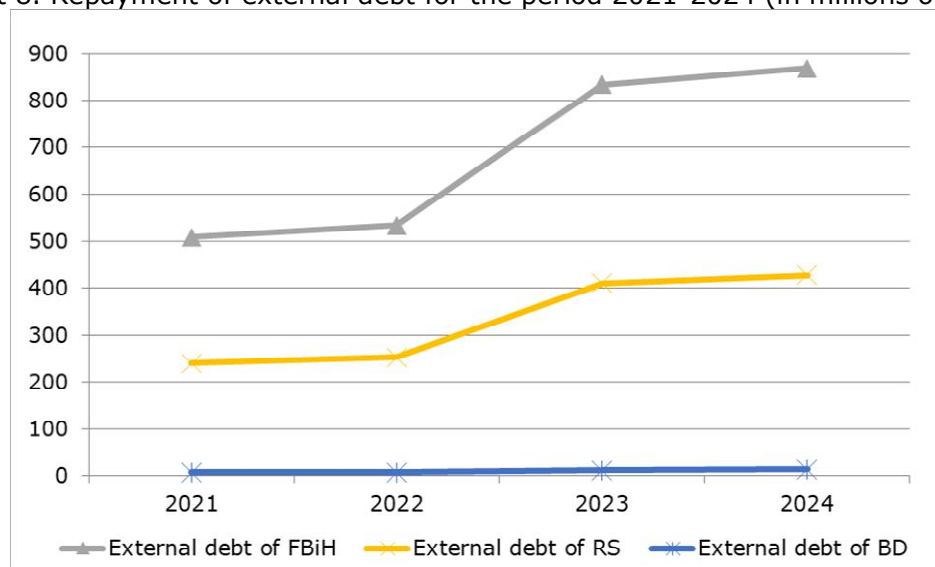
## 2. External debt

After the corresponding funds for minimum reserves are allocated from the total collected gross revenues and after the corresponding amount is allocated for the financing of BiH institutions, the amount for financing the external debt is allocated as a priority, before allocation to the entity and Brčko District. In accordance with the maturity dynamics, the amount intended for the financing of the external debt is subtracted from the total funds intended for allocation to the entities and Brčko District. Although the external debt towards foreign creditors is recorded as a liability of BiH, it is a liability of the entity and Brčko District and the amount for its financing is not allocated to the budgets of the entities and Brčko District<sup>14</sup>.

Chart eight shows the trend in the allocation of revenues from indirect taxes intended for financing external debt in the period 2021-2024, in millions of BAM.

<sup>14</sup> The repayment plan and payment dynamics are determined by the schedule of the Ministry of Finance and Treasury of BiH, while the payment procedure is carried out by the Central Bank as a fiscal agent.

Chart 8. Repayment of external debt for the period 2021-2024 (in millions of BAM)



Source: Data from the Indirect Taxation Authority of BiH, MAU overview

In accordance with previously assumed international obligations and the dynamics of repayment of external debt, the largest repayment of entities and Brčko District in the observed period on an annual level was recorded in 2024. Thus, in 2024, the each entity repaid 4.2% more external debt compared to the repayment of this debt in 2023, while the repayment of Brčko District was for 26.7% higher.

Table three shows the participation of entities and Brčko District in the total allocations for repayment of external debt for the period 2021-2024.

Table 3.

in %	2021	2022	2023	2024
External debt of FBiH	67.2	67.1	66.4	66.3
External debt of RS	31.9	31.9	32.7	32.7
External debt of BD	0.9	1.0	0.9	1.1
Total	100	100	100	100

Source: Data from the Indirect Taxation Authority of BiH, MAU overview

Table four shows the change in p.p. in the participation of entities and Brčko District in the total allocations for repayment of external debt for the 2024 compared to the 2023, 2022 and 2021.

Table 4.

change in p.p.	Index (2024-2023)	Index (2024-2022)	Index (2024-2021)
External debt of FBiH	-0.1	-0.9	-0.9
External debt of RS	-0.1	0.7	0.8
External debt of BD	0.2	0.1	0.1

Source: Data from the Indirect Taxation Authority of BiH, MAU overview



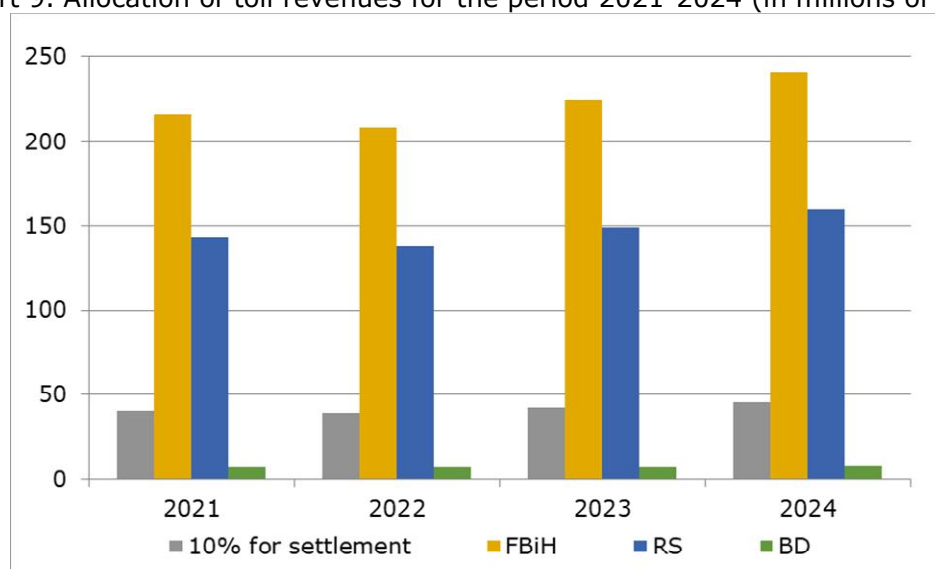
Compared to 2023, in 2024, the entity's participation in the repayment of external debt decreased (-0.1 p.p.), while the participation of Brčko District in the repayment of this debt increased by 0.2 p.p.

### 3. Revenues from tolls for highways

Toll revenues<sup>15</sup> are collected on a separate sub-account within the single account opened at the Central Bank of BiH, and their allocation is done in accordance with the Law on Payments to the Single Account and Allocation of Revenues<sup>16</sup>. Of the total collected revenues, 10% remains in the sub-account of the single account and serves to settle the revenues after determining the final allocation methodology, while the remaining 90% is divided between the entities and Brčko District according to the established percentages: the Federation of BiH 59%, the Republic of Srpska 39%, Brčko District 2%<sup>17</sup>.

Chart nine shows the amount that was allocated according to the prescribed methodology in the period 2021-2024, in millions of BAM.

Chart 9. Allocation of toll revenues for the period 2021-2024 (in millions of BAM)



Source: Data from the Indirect Taxation Authority of BiH, MAU overview

The amount of 10%, which according to the current Decisions is kept on the sub-account of the single account and is used to settle the revenues after determining the final allocation methodology, is accumulated until the decision of the Governing Board of the Indirect Taxation Authority on the temporary allocation of the toll revenues for highways that remained on the sub-account of the single accounts is adopted<sup>18</sup>.

<sup>15</sup> The amount of road tax per liter of derivatives sold on the BiH market in the analyzed period is 0.25 BAM; Law on Amendments to the Law on Excise Taxes in BiH, "Official Gazette of BiH", No. 91/17

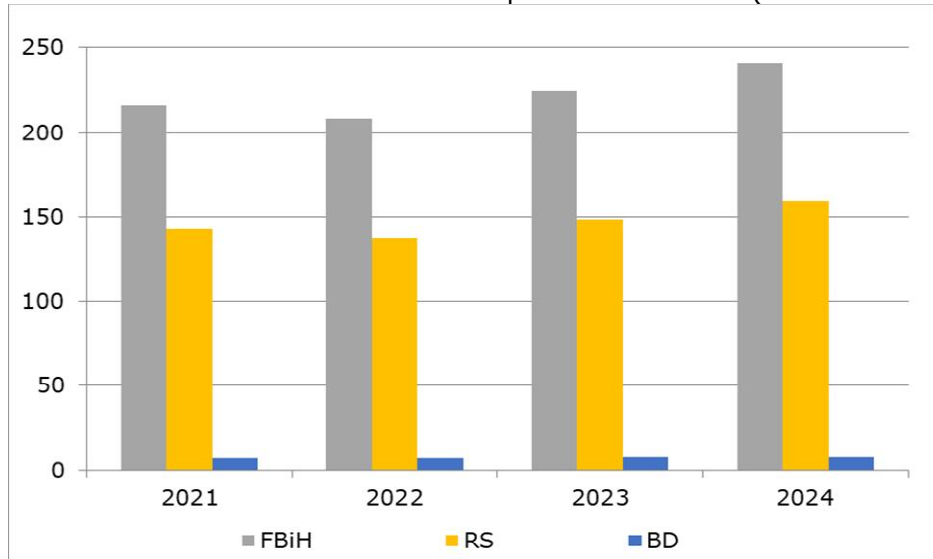
<sup>16</sup> "Official Gazette of BiH", No. 55/04, 34/07, 49/09, 91/17

<sup>17</sup> In accordance with the Decision on the temporary allocation of toll revenues for highways, "Official Gazette of BiH", No. 102/09 and the Decision on the temporary allocation of toll revenues for the construction of highways and the construction and reconstruction of other roads, "Official Gazette of BiH", no. 50/18

<sup>18</sup> The allocation of part of the accumulated amount intended for settlement from the sub-account of the single account was not carried out in the period used in this analysis. More precisely, it was carried out in earlier years in accordance with the Decision on the temporary allocation of toll revenue for highways accumulated on a sub-account of a single account; "Official Gazette of BiH", No. 83/11, 62/13, 67/15, 42/17

Chart 10 shows the corresponding amount allocated to entities and Brčko District during regular allocation.

Chart 10. Allocation of toll revenue for the period 2021-2024 (in millions of BAM)



Source: Data from the Indirect Taxation Authority of BiH, MAU overview

The movement of the allocation shown in the chart does not include the period of legal changes in terms of the amount of revenue from dedicated tolls, as well as additional allocation in accordance with the Decisions, and there are no significant fluctuations in the allocation of toll revenue on an annual basis in the period shown. The total amount of revenue from highway tolls in 2024 is higher by 7.2% compared to 2023, while compared to 2022 it is higher by 15.6% and compared to 2021 it is higher by 11.6 %. Given the fixed coefficient of allocation of these revenues, the increase per user is proportional to the total increase.

## Small business policies and VAT systems

(Author: Dinka Antić, PhD)

*The VAT threshold, on the one hand, represents a lever for fiscal authorities to ensure a privileged position of small businesses in the VAT system, and, on the other hand, an important instrument for conducting business policy of small businesses. Small businesses are in a worse position in terms of VAT administration costs compared to large companies, given the largely fixed nature of tax compliance costs. For this reason, in most VAT systems there is a threshold for VAT registration, which exempts small businesses from the legal obligation to register. If legal provisions allow for voluntary VAT registration, small businesses have the option of choosing to operate within the VAT system or to remain outside the VAT system. In order to make the right decision, it is necessary to analyze the advantages and disadvantages of operating within the VAT system and outside it.*

### INTRODUCTION

The analysis<sup>19</sup> of the implications of the VAT registration threshold has shown that VAT registration has both advantages and disadvantages, especially for small taxpayers. A small company, whose turnover is below the VAT registration threshold, has basically two business policies or two responses to the existence of the threshold – to be outside the VAT system or to enter the VAT system under voluntary registration, if it is provided for as an option by law. However, things are not so simple and clear in the business world, since economic growth, as well as inflationary effects, can put a small company in a situation where it must register for VAT if it does not want to break the law and commit tax evasion.

According to Lockwood and Liu<sup>20</sup> there are the following three responses of small firms to the prescribed threshold for registration:

- i. voluntary registration
- ii. maintaining turnover just below the threshold for registration (so-called bunching)
- iii. limiting the growth of the company.

Keeping the turnover of small companies below the legal threshold and activities to limit growth represent business strategies outside the VAT system. The difference between the last two options compared to voluntary registration is that a small company **does not want** to be in the VAT system at any cost, and is exploring ways to achieve this. The last two options, which basically represent legal tax evasion, imply doing business outside the VAT system at a certain price or sacrifices that the company is willing to make.

On the other hand, voluntary registration represents the opposite strategy, because it implies the entry of a small company into the VAT system, even though it is not obliged by law. It is a kind of paradox. Although companies are not required by law to register, and there is no prospect that they will have this obligation in the near future, after considering the benefits and costs, they decide that doing business in the VAT system brings net benefits. Elaboration of the negative effects of small business operations in the VAT system does not provide a rational explanation for such a strategy, but analyses can show the existence of factors that make voluntary registration an attractive business strategy for the growth of small companies.

<sup>19</sup> Antić, D. (2024). „New VAT threshold in Bosnia and Herzegovina: Analysis of the implications of the (too) high threshold on the example of Great Britain “. MAU Bulletin No. 231/232, September/October 2024., [www.oma.uino.gov.ba](http://www.oma.uino.gov.ba).

<sup>20</sup> Lockwood, B. i Liu, L. (2015). "Efficiency and welfare costs of VAT: evidence from VAT notches". *Policy paper series*. Oxford: Oxford University, Centre for Business Taxation.

## OPTION #1: STAY OUT OF THE VAT SYSTEM

By doing business outside the VAT system, taxpayers save on resources that they would otherwise have to hire for inclusion in the VAT system. The non-inclusion of small businesses in the system has a positive impact on taxpayers' costs and profits, and thus on the amount of revenues from profit and income taxes, which would be lower in the case of existence of costs related to inclusion in the VAT system.

According to economists' estimates,<sup>21</sup> the costs of tax compliance born by taxpayers amount to 2% of the turnover, which can represent a significant amount for small companies, while for large companies they amount to 0.3% of turnover. More recently, rising compliance costs due to increasing digitalization have been considered a factor for doing business outside the VAT system. The costs of digitization are mostly fixed and thus affect small businesses more than larger companies. Analysis of possible business policies for small business registration today necessarily includes an assessment of the cost implications of doing business in the era of digitization, including compliance with VAT regulations (electronic communication with tax administration, e-invoices, e-archiving, e-reporting, e-filing). Experts of the British Chartered Institute of Taxation (CIOT)<sup>22</sup> believe that digitization has exacerbated the problem of doing business for small companies in the VAT system, because the VAT system has become more complex, requiring additional administration and compliance with the obligations imposed by business and VAT payment in digital era<sup>23</sup>, which increases costs for small companies to a greater extent than is the case with larger companies.

## OPTION #2: VOLUNTARY REGISTRATION

Voluntary registration gives full freedom to small businesses to decide whether to join the VAT system or remain outside it, based on their preferences and the results of a cost-benefit analysis. Experts<sup>24</sup> believe that the voluntary registration option is an element of good design and structuring of the VAT system. The study<sup>25</sup>, which was based on data on taxpayers in the UK, showed that voluntary registration is the optimal choice for small businesses if they mainly sell goods or provide services to VAT taxpayers, because they can pass the VAT burden to the buyer, who is entitled to deduct input VAT. However, there are other reasons for the high share of companies that are voluntarily registered in the total number of VAT payers. A factor that encourages companies to enter the VAT system on a voluntary basis is the possibility of VAT fraud, since concealment of sales allows for underreporting of VAT liabilities and withdrawal of refunds. Similarly, the research has shown that a large number of voluntarily registered companies are also the result of failure to deregister, most often due to the fixed costs of deregistration.

Research<sup>26</sup> has shown that the following three parameters are crucial and need to be analyzed when making a decision to enter the VAT system:

- The amount of input costs in relation to turnover;
- Sales structure;
- Market structure.

<sup>21</sup> IFS. (2011). „A Retrospective Evaluation of Elements of the EU VAT System “. London.

<sup>22</sup> CIOT – The Chartered Institute of Taxation. (2022). "Cruel dilemmas for small businesses over frozen VAT threshold".

<sup>23</sup> In Great Britain, since 2018, a digitalization system for VAT under the name "Making Tax Digital for VAT" has been applied, and all taxpayers are required to register for the given system, apply the prescribed rules and acquire adequate software.

<sup>24</sup> Crawford, I., Keen, M., and Smith, S. (2011). "Value Added Tax and Excises" in "Dimensions of Tax Design". Mirrlees Review. London: Institute for Fiscal Studies.

<sup>25</sup> Lockwood, B. I Liu, L. (2016). "VAT Notches, Voluntary Registration, and Bunching: Theory and UK Evidence". Warwick University.

<sup>26</sup> Liu, L, Lockwood, B., Almunia, M., and Tam, E.H.F. (2019). "VAT Notches, Voluntary Registration, and Bunching: Theory and UK Evidence". Working Paper. Washington: IMF.

### *Input costs*

Entering the VAT system for a company with high input costs allows the deduction of input VAT from purchases. The amount and structure of a small company's costs depends on the type of activity. The category of small companies is largely heterogeneous, so there is no single pattern of behavior that could be applied to all small companies. Whether voluntary registration is suitable for a small company depends on the type of activity it is engaged in. Entrepreneurs who mainly provide their services to final consumers (households) use inputs to a lesser extent from suppliers who are VAT payers. It would not be advantageous for this group of small companies to enter the VAT system, because the VAT liability would greatly exceed the cost of VAT in the price of the inputs they use in providing the service. On the other hand, the costs of a small company that, for example, designs and installs heating and air conditioning are to a greater extent burdened by VAT from inputs, so it is a better option for them to operate in the VAT system, especially since they are often subcontractors of large VAT companies.

### *Sales structure*

Another parameter that determines entry into the VAT system is the sales structure. It is necessary to analytically determine the share of sales to taxpayers in the total turnover (so-called B2B<sup>27</sup> sales) and the share of sales to final consumers (B2C<sup>28</sup>), which includes retail sales and sales to other persons who are exempt from paying VAT (government institutions, banks, insurance companies, post offices etc.). In situations of doing business with taxpayers, passing the VAT burden to buyers has no effect on the sale, since the buyer, as a VAT payer, can deduct input VAT from such a transaction. Inclusion in the VAT system allows small companies to use the right to deduct input VAT and thereby reduce their tax liability, with the fact that, if the customers of the small company are solvent, VAT as a claim does not burden business costs, and thus does not affect profit of the company. However, inclusion in the VAT system in such circumstances is the optimal solution if a small company exclusively procures inputs from VAT payers, and is able to fully deduct input VAT. However, if part of the small company's purchases is from entities that are not VAT payers or are exempt from VAT, then the VAT from the purchases burdens the cost price, and is passed on to the customer through the selling price, if the small company is in such a market position. It can be concluded that voluntary registration is the optimal solution if a small company in the supply chain is in an intermediate stage between suppliers who are VAT payers and customers who are also liable for VAT.

### *Market structure*

The third parameter that should be considered when deciding on voluntary registration is the market structure. This is of great importance for small companies that mainly do business with final consumers. Entering the VAT system would mean an increase in the sales price by the amount of VAT that must be charged on the invoices issued to consumers and paid to the government. The position in the VAT system enables the deduction of input VAT for all sales transactions, including sales to the final consumers, and the final customers ultimately bear the VAT that is charged to them at the time of sale. The negative side of entering the VAT system is a worse competitive position due to higher sales prices than in the case of a small company outside the VAT system, since VAT in purchases burdens sales prices less than the standard VAT rate, making a small company more competitive. Whether a small company will be able to increase sales prices due to entering the VAT system depends on the market structure. Passing on the VAT burden through prices to the consumer is possible in the case of an inelastic demand, reacting weakly or not at all to an increase in sales prices. Most often, these are local goods, basic foodstuffs, luxury goods or utility services, which are bought by local consumers who cannot or

<sup>27</sup> B2B - Business to Business

<sup>28</sup> B2C - Business to Consumer

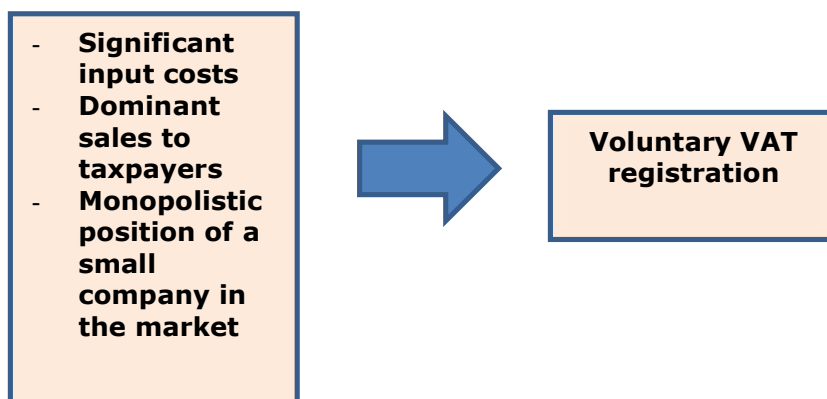
have no interest in buying them in other areas, due to the high transportation costs in relation to the price of the good. In such situations, the seller has a monopoly on the market. However, small companies are usually not in a position to dictate sales prices, especially if the small company is a supplier or subcontractor of a large company that dictate the terms of procurement, and thus the prices at which they purchase goods or services from small companies. In such a market structure where monopsony buyers dominate, the business of a small company outside the VAT system (i.e. "below the threshold") would mean a decrease in profit, if it is not able to shift the amount of VAT from its inputs to the consumers of its services or goods. In such circumstances, the option of voluntary registration is suboptimal, because it does not provide maximum effects due to the impossibility of shifting the VAT burden to the sales price.

## OPTION ANALYSIS

From the above elaboration, it can be concluded that voluntary VAT registration is more likely in the following three situations (Chart 1):

- (i) high input costs in relation to turnover;
- (ii) high share of sales to VAT payers in the structure of sales to final consumers;
- (iii) when there is no competition in the market, so the company earns a higher margin.

Chart 1: Parameters "FOR" voluntary registration

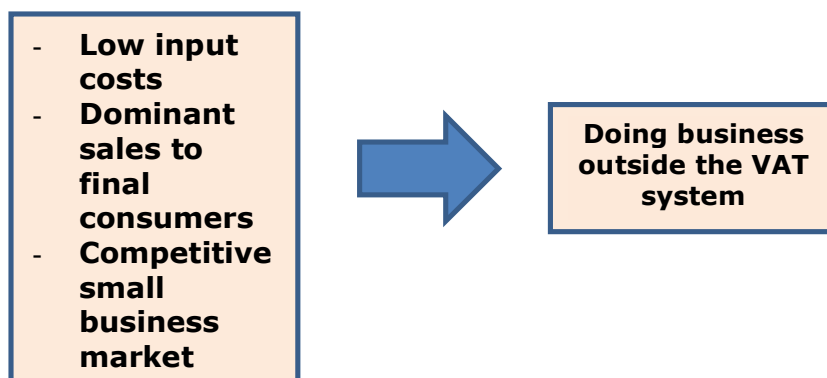


On the contrary, a small company should not register for VAT if it meets the following conditions (Chart 2):

- (i) when input costs in relation to turnover are very low or insignificant;
- (ii) when there is a high proportion of sales to final customers in the sales structure;
- (iii) when a small company operates on a competitive market.



Chart 2: Parameters "AGAINST" voluntary registration



### OTHER FACTORS "FOR" AND "AGAINST" VOLUNTARY REGISTRATION

In addition to economic and financial reasons, there are other reasons that make voluntary registration an attractive option for small businesses. Having status of a VAT payer is important for business, because in the business world it makes the company appear larger and more stable than it actually is. Not only can it attract customers, but by having the status of a VAT payer, a small business gains a more favorable position when contracting purchases from suppliers, with investors, and when applying for loans from banks or other financial institutions. VAT status changes the perception of the aforementioned entities about the company's turnover. The visible element of the VAT status is the VAT number, which is stated on invoices, on the website, in business correspondence, in business databases and databases of active taxpayers located on the portals of the tax administration, which also gives greater importance to the company and increases its reputation in relation to small business and crafts. Likewise, the status of a VAT payer is useful internally for improving the organization of the work of a small company and its bookkeeping, which, due to possible tax controls, should be up-to-date and accurate, which ultimately improves the overall operations of the small company and has a favorable effect on all entities with which the small company does business (customers, suppliers, investors, banks, etc.), because it instills confidence in the accuracy of accounting reports and records.

However, practice shows that the above-mentioned parameters for voluntary registration can also lose their significance in a situation where circumstances arise that a small company can, in accordance with the law, exit the VAT system, e.g. if the VAT threshold is increased by law or due to a drop in the company's turnover below the threshold, caused by unfavorable internal or external factors (crisis, wars, natural disasters, etc.). In such circumstances, economic parameters (input costs, sales structure and market structure) are not relevant for remaining in the VAT system, but deregistration costs.