



INTERNATIONAL INSTITUTE FOR PRIVATE
COMMERCIAL AND COMPETITION LAW
(IIPCC-LAUSTRIA)

Research Article

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A perspective on the history of Value Added Tax (VAT) in general and its application in the field of agriculture in Albania

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DOI: <https://doi.org/10.2478/ejels-2026-0011>

Abstract

This article examines the history of the Value Added Tax (VAT) and its implementation in the agricultural sector in Albania. Although VAT has been applied in Albania since 1996, it has undergone several legal changes over time with respect to tax rates and application within this sector. Recent changes in VAT rates have affected the prices and costs of agricultural inputs, as well as the determination of market selling prices for agricultural products.

Given the significant role of agriculture in the Albanian economy, this article aims to analyze VAT rates, along with the VAT compensation and crediting schemes applied across the main agricultural branches. It also identifies the challenges encountered throughout the agricultural supply chain. Additionally, the article highlights selected practices used by European Union (EU) countries in the application of VAT in agriculture.

Keywords: VAT, VAT rate, agricultural sector, agricultural producer, compensation.

1. Introduction

Agriculture is considered a vital sector and a key driver of economic development in Albania, accounting for the largest share of employment at 37% (INSTAT, 2024). It also has a positive impact on the country's foreign trade, with fruit and vegetable exports reaching a value of 10.4 billion ALL, or approximately EUR 84 million, in 2020 (AIDA, 2021). In addition, agriculture is closely linked to other sectors, such as agrotourism and agro-processing.

Due to its inherently "fragile" nature, the Albanian government has recently sought to prioritize and further develop the agricultural sector through various fiscal policies, including changes to VAT compensation rates for agricultural producers, seedlings, inputs, and agricultural machinery (SBZHRP, 2022).

This article focuses on the agro-processing sector with respect to VAT rates and analyzes all stages of the VAT chain, from the agricultural producer to the final

consumer. As a fiscal instrument, VAT applies to registered taxable persons and is classified as a consumption tax levied on goods and services at each stage of the production and distribution process. VAT is calculated as a percentage of the price of goods and services and becomes payable after deducting input VAT that directly affects the cost components of goods and services.

Currently, the standard VAT rate for domestic sales of goods and services, including agricultural and livestock products, is 20% for registered taxable entities, while the VAT rate for exports of goods is 0%, as illustrated in Table 1.

Table 1. VAT rate on sales of agricultural products and by-products

Type of sales	VAT rate
Exports	0%
Domestic sales 20%	20%

Source: General Directorate of Taxes

Furthermore, we will highlight the change in VAT reimbursement rates for agricultural producers in Albania over the years (referring to the last 10 years) according to the table below:

Table 2. VAT reimbursement rate for agricultural producers over the years

Period	VAT compensation rate
Until August 2014	6%
September 2014- December 2018	20%
January 2019 – December 2021	6%
January 2022 – currently	0%

Source: General Directorate of Taxes

Changes in VAT rates have also affected government budget revenues, as an effective tax system plays a crucial role in ensuring revenue stability and supporting a country's fiscal policy objectives. According to the applicable legal framework, the minimum VAT registration threshold is an annual turnover of ALL 10,000,000 (ten million) per calendar year, which is approximately EUR 100,000 (exchange rate: EUR 1 = ALL 100).

This analysis addresses two main categories within the agricultural sector: agro-processing entities registered for VAT and agro-processing entities operating below the VAT registration threshold. To better assess the effects of a non-uniform VAT rate, the analysis focuses on agro-processing entities that are registered for VAT.

Despite changes in VAT rates applicable to purchases from agricultural producers, the VAT rate on domestic sales has remained unchanged during this period, remaining a uniform rate of 20% for all VAT-registered entities. From this perspective, a tax gap may arise because an agro-processor registered for VAT currently credits VAT at a rate of 0% on the purchase of raw materials (e.g., fruits, vegetables, milk, and meat), while applying a 20% VAT rate on domestic sales, inclusive of the profit margin.

Under a uniform VAT rate of 20%, an agro-processor would pay VAT only on the difference between the taxable value of sales and the taxable value of purchases.

However, under a non-uniform VAT rate, a tax gap of 20% emerges, potentially resulting in higher VAT liabilities for certain entities. For example, if an agro-processor or trader registered for VAT purchases raw vegetables from an agricultural producer at a taxable value of ALL 100,000, the VAT credit or deduction would be ALL 0 ($ALL\ 100,000 \times 0\%$). In this case, agricultural producers also do not benefit, as the VAT compensation rate is 0%.

If the purchased agricultural products are processed and sold on the domestic market at a taxable value of ALL 200,000, the VAT on sales would amount to ALL 40,000 ($ALL\ 200,000 \times 20\%$), or approximately EUR 400. Consequently, the VAT payable would be ALL 40,000 (VAT on sales of ALL 40,000 minus VAT on purchases of ALL 0). By contrast, if a uniform VAT compensation rate of 20% were applied, the VAT payable would be reduced to ALL 20,000 ($ALL\ 40,000\ \text{minus}\ ALL\ 20,000$), or approximately EUR 200.

The functioning of this VAT scheme along the supply chain—from the agricultural producer to the final consumer—is illustrated in Figure 1.

Fig.1 VAT rate chain from the agricultural producer to the final consumer

	Agricultural inputs traders	Farmers	Agro- processors	Merchants	Final Consumer
VAT compensation rate on purchases	10%	0%	0%	20%	0%
VAT rate on sales	10%	0%	20%	20%	

From an economic perspective, this brings three negative impacts.

First, a non-uniform VAT rate is likely to lead to an increase in the prices of agricultural products, thereby placing a greater burden on consumers and making these products more expensive and less attractive.

Second, a non-uniform VAT rate may threaten the sale of domestically produced agricultural goods and encourage increased reliance on imported goods and raw materials. This occurs because agro-processors can credit VAT at a rate of 20% on imported inputs, which discourages the purchase of domestic agricultural products. As a result, domestic agricultural producers may reduce production. It should be emphasized that the agricultural sector, in addition to its substantial contribution to national GDP, plays a critical role in employment, self-employment, and poverty alleviation.

Thirdly, a decrease in consumption as a result of rising prices and an increase in the imports of these products would lead to a slowdown in economic growth, GDP^1 , and a deterioration of the country's trade balance.

Regarding VAT in relation to other sectors, agriculture has been treated differently. This is due to several factors such as the high administrative costs in agriculture.

¹ $GDP=C+I+G+N$ C =Consumption, I =Investment, G =Government spending, N (Exports-Imports).

2. Methodology

The methodology employed in this article is primarily based on secondary data obtained from publications issued by various institutions, including the General Directorate of Taxes, INSTAT, the relevant ministries, and associated agencies. The data are quantitative in nature and are analyzed using descriptive and comparative approaches.

The literature review, as a scientific research method, involves the systematic collection and critical examination of existing sources related to the study topic. This approach provides an overview of the current state of knowledge, identifies research gaps, and analyzes key theoretical perspectives and practical applications. Through careful selection and evaluation of relevant sources, the literature review establishes a solid theoretical foundation for the study and supports the selection of appropriate research methods.

The literature review draws on scientific articles by both domestic and international authors addressing VAT-related issues. Specifically, it examines the historical development of VAT, its application in the agricultural sector in Albania, VAT compensation mechanisms, the implementation of non-uniform VAT rates, and alternative VAT models applied to agriculture in other countries.

In addition, the analysis considers VAT within the framework of the relevant European Union (EU) directives and reviews how different countries and scholars address the application of non-uniform VAT rates in specific sectors. Supplementary information has been collected from bulletins, academic journals, and scientific publications in the fields of economics and agribusiness.

3. The history of VAT in general, the EC Directive on VAT, and the economics of VAT

The origins of the Value Added Tax (VAT) can be traced to France in the early twentieth century, with its initial application dating back to 1920. The modern structure of VAT was established in France in 1954 by Maurice Lauré and is generally regarded as an evolution of the production tax system that existed prior to that period. From a doctrinal perspective, the first proposal for a tax mechanism based on value added at each stage of production was advanced by Wilhelm von Siemens in 1918. This concept was later developed in the 1920s by the American economist Thomas Adams, who advocated VAT as a form of indirect taxation to replace income taxation for American corporations.

VAT is one of the longest-standing taxes in Europe. In 1967, a definitive VAT system was established to operate within the European Community through the adoption of a unified legal framework. Specifically, on May 17, 1967, the Sixth VAT Directive (Directive 67/227/EEC) was adopted, defining the scope of application, territorial coverage, taxable value, chargeable events, and input tax credit mechanisms. VAT began to be more widely applied in Europe in 1977 with the entry into force

of the Sixth Directive and subsequently became a requirement for membership in the European Union (formerly the European Community). The Directive aimed to ensure that goods were taxed in their country of origin and to promote tax neutrality by applying VAT comprehensively across all stages of production, distribution, and service provision.

According to the Directive, although VAT rates and exemptions are not fully harmonized, they must remain neutral in terms of competition by ensuring an equivalent tax burden regardless of the length of the production and distribution chain. To prevent distortions of competition arising from divergent VAT rates across sectors, EU legislation requires the maintenance of a minimum standard VAT rate of 15% and allows for up to two reduced rates of no less than 5%. Certain older member states may apply lower rates under “standstill” or reserved rights provisions. Excessive reductions in VAT rates may undermine the functioning of the internal market and violate the principle of fiscal neutrality.

OECD reports consistently indicate that the most efficient VAT system is one characterized by a single rate applied to a broad tax base, as differentiated rates tend to increase legal complexity and uncertainty. In Albania, VAT was introduced on July 1, 1996, and this form of taxation is currently applied in 174 countries worldwide (OECD, 2022).

As a consumption tax levied on goods and services at each stage of production and distribution, the application of VAT in the agricultural sector entails significant economic, social, and administrative implications. Although VAT is theoretically considered neutral and efficient, its practical effects depend largely on the tax structure, the scope of exemptions, and the effectiveness of reimbursement mechanisms. Due to its strategic importance for food security, rural development, and environmental sustainability, agriculture is frequently subject to differentiated VAT treatment within fiscal systems. Key characteristics of VAT application in the agricultural sector include the following:

3.1 The basic VAT Mechanism in Agriculture

In a standard VAT system, farmers or agribusinesses calculate VAT on their sales by deducting (crediting) the VAT paid on their purchases, with the resulting difference constituting the VAT payable. This mechanism ensures that the final consumer ultimately bears the full VAT burden, while producers and intermediaries transfer the tax along the economic supply chain.

In the agricultural sector, supplies subject to VAT typically include seeds, chemical fertilizers, pesticides, machinery, veterinary services, animal feed, and related inputs. Farmers registered for VAT are entitled to claim input VAT refunds on these purchases, thereby reducing their effective tax burden. In contrast, non-registered farmers cannot deduct input VAT, which increases production costs and reduces profitability.

3.2 Economic Consequences of VAT in Agriculture

3.2.1 Effects on Prices and Competitiveness

VAT influences agricultural prices depending on the extent of its application and the efficiency of the refund system. When input VAT is not refundable, production costs increase and may either be passed on to consumers through higher prices or absorbed by producers through reduced profit margins. This situation weakens the competitiveness of domestic agricultural products, particularly in export markets or in competition with subsidized imports. Conversely, timely VAT refunds and exemptions for basic food products can neutralize the tax burden, enhance efficiency, support competitiveness, encourage formalization, and stimulate investment in the agricultural sector.

3.2.2 Revenue Generation and Redistribution

Agriculture accounts for a substantial share of GDP and employment in many developing economies, yet it often remains under-taxed. Expanding VAT coverage in agriculture can contribute to increased public revenues; however, policymakers must carefully balance revenue objectives with the risk of imposing excessive burdens on rural producers and food systems. Thoughtful policy design—such as exempting basic foodstuffs while taxing luxury or non-essential products—can enhance the equity and progressivity of VAT.

3.2.3 Encouraging Formalization

An effectively functioning VAT system can promote formalization within the agricultural sector. VAT registration provides access to input tax refunds, business financing, and broader markets, while also improving transparency and record-keeping. Nevertheless, complex administrative procedures and limited institutional capacity may discourage small-scale farmers from participating in the VAT system.

3.3 Challenges in Implementing VAT in Agriculture

The implementation of VAT in agriculture presents several practical challenges. First, informality remains widespread, as a significant portion of agricultural production is either informal or intended for self-consumption. This limits VAT effectiveness, as many farmers lack adequate documentation or the capacity to interact with tax authorities.

Second, the administrative burden associated with monitoring VAT compliance in rural areas can be substantial. Ensuring timely VAT reimbursements is particularly critical to maintaining farmers' cash flow and trust in the tax system.

Finally, VAT implementation in agriculture is politically sensitive due to the sector's social and economic importance. Attempts to reduce exemptions on food products or agricultural inputs often encounter strong political and public resistance.

4. VAT in the agriculture sector in Albania and the implementation of the compensation scheme

VAT is the most important source of revenue from the total taxes and duties in the

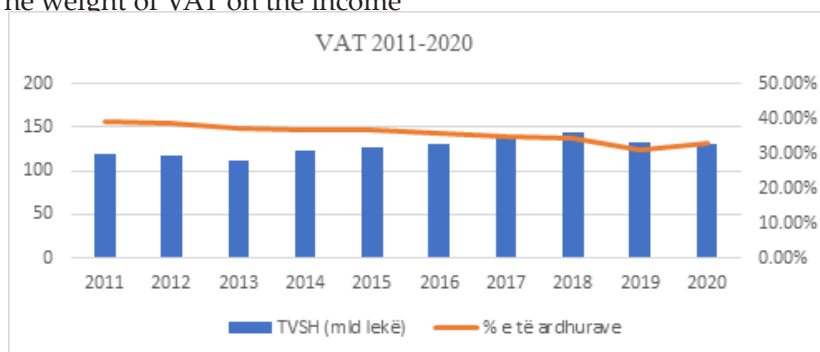
state budget, accounting for a specific share of around 37% and about 8.8% of the country's GDP. (IMF 2022).

The revenue collected from VAT in the state budget in relation to tax revenues in Albania for the period 2011-2020 is presented in the table and chart below:

Viti	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
VAT (billion ALL)	119.2	116.5	111.9	123.7	125.8	131.4	139.5	143.5	132.4	130.4
% of Income	39.2%	38.7%	37.3%	36.8%	36.8%	35.5%	35%	34.2%	31.1%	32.7%

Source: Ministry of Finance

Fig.2 The weight of VAT on the income



In the Republic of Albania, VAT in the agricultural sector is regulated by Law No. 92/2014, *On Value Added Tax in the Republic of Albania* (as amended), together with the relevant implementing instructions. Since January 2022, the VAT compensation rate for agricultural producers has been set at 0%. Under the applicable tax legislation and administrative guidelines, agricultural producers benefiting from the VAT compensation scheme are exempt from the obligation to issue VAT invoices, submit VAT declarations, and maintain accounting records. The compensation scheme applies to agricultural producers who, in the course of their production activities, supply agricultural products or services to taxable persons in the Republic of Albania who do not themselves benefit from the compensation scheme. Agricultural producers participating in the farmers' compensation scheme may, however, opt to apply the standard VAT regime, under which a uniform VAT rate of 20% applies.

To qualify for the VAT compensation scheme, agricultural producers must meet the following conditions:

- Their annual turnover does not exceed the minimum VAT registration threshold established by a decision of the Council of Ministers, currently set at ALL 10 million (approximately EUR 100,000, based on an exchange rate of EUR 1 = ALL 100).
- They supply goods or services generated directly from agricultural activities.
- The goods or services are supplied to taxable persons in the Republic of Albania

who do not benefit from the compensation scheme.

- They are registered with a Tax Identification Number (NIPT) issued by the Regional Tax Directorate in the jurisdiction where the agricultural activity is conducted.

4.1 Alternative methods for implementing non-uniform VAT rates

According to the tax legislation *On Value Added Tax in the Republic of Albania*, farmers purchase agricultural inputs, seedlings, and pesticides subject to a 10% VAT rate. Because farmers participating in the compensation scheme cannot credit input VAT or deduct VAT on sales, this tax becomes an additional cost of production. As discussed above, agro-processors are likewise unable to credit VAT on purchases from farmers, and the application of a non-uniform VAT rate increases costs along the production and distribution chain, ultimately affecting the final selling prices of agricultural products.

In line with the principle of VAT neutrality, farmers, agro-processors, and traders of agricultural products should ideally be subject to a uniform VAT rate. This would allow each participant in the distribution chain to deduct VAT on purchases, pay net VAT when output VAT exceeds input VAT, or receive reimbursement when input VAT exceeds output VAT. To address the distortions created by non-uniform VAT rates in agriculture, several alternative approaches to VAT treatment may be considered:

- Taxation Regime; Under this approach, farmers are fully subject to the standard VAT regime, similar to other business entities. This allows for full input VAT deduction and ensures neutrality across the supply chain.
- Exemption Regime; This regime exempts farmers from VAT obligations altogether. While administratively simple, it may lead to higher production costs if input VAT cannot be recovered and may disrupt VAT neutrality.
- VAT relief for exempt farmers can be implemented through several mechanisms:
 - Exemption or reduced VAT rates on agricultural inputs. Basic food products, unprocessed agricultural products, and essential inputs are often exempt from VAT or subject to reduced or zero rates. This approach lowers food prices for consumers and reduces the tax burden on farmers. However, exemptions may distort production decisions and complicate VAT reimbursement procedures.
 - Flat-rate scheme. Under a flat-rate scheme, farmers either charge a presumed VAT rate reflecting the average VAT paid on inputs, which taxable buyers deduct, or farmers do not charge VAT on output while buyers deduct a presumed amount corresponding to input VAT paid by farmers and transfer this amount to the farmers.
 - Direct monetary compensation. Farmers receive direct financial compensation from the government for VAT paid on agricultural inputs. Reimbursement is granted upon submission of individual claims to the competent authorities.
- VAT Relief on Sales of Agricultural Products. Under this approach, agricultural products may be exempt from VAT, taxed at a zero rate, or subject to reduced rates compared to the standard VAT rate.

5. Conclusions and Recommendations

At present, agro-industrial entities registered for VAT in Albania operate under a non-uniform VAT system. These entities apply a standard VAT rate of 20% on the taxable value of domestic sales, while they are unable to credit VAT on purchases from domestic agricultural producers, most of whom are not registered for VAT and are subject to a VAT compensation rate of 0%. This situation disrupts the VAT balance and undermines the principle of tax neutrality.

The application of VAT in the agricultural sector is widely regarded as challenging due to distributional policy objectives and high levels of informality. The sector is predominantly composed of small-scale farmers who fall below the VAT registration threshold, making accounting, documentation, and tax compliance more difficult. To address these challenges, several alternative methods for calculating the VAT tax base have been proposed. For example, taxable entities may calculate VAT based on the full sales price with entitlement to input VAT deductions, or alternatively apply a simplified effective VAT rate on sales while forfeiting the right to deduct input VAT. Under the first approach, VAT is applied at the standard rate of 20% on the taxable value of sales, with input VAT deductions allowed. For instance, if an agro-processing entity records taxable sales of ALL 100,000 and purchases of ALL 80,000 from non-VAT-registered farmers, the VAT payable on sales would be ALL 20,000. In contrast, under the effective VAT rate approach, assuming a price margin of 25%, an effective VAT rate of 5% would apply. In this case, the VAT payable would be ALL 5,000 ($ALL\ 100,000 \times 5\%$).

Although the use of an effective VAT rate may simplify administration, it can result in price differentials that distort economic decision-making. Moreover, applying a low effective VAT rate poses a risk of reduced VAT revenues. Agro-processors may either absorb the additional VAT cost through reduced profit margins or transfer it to the final consumer through higher prices. In the latter case, a cascading effect on prices and state revenues may occur, consistent with the input–output model described by Priyogo and Nasrudin (2023).

The alternative VAT calculation method may increase participation in the VAT system among agricultural producers and entrepreneurs, while allowing fiscal policy to be adapted to sector-specific conditions. Nevertheless, ensuring VAT neutrality at every stage of the supply chain remains the most effective means of preventing economic distortions and preserving fairness within the tax system.

To enhance the efficiency and equity of VAT application in agriculture, several policy measures are recommended. These include strengthening tax administration and farmer education to improve compliance, simplifying VAT refund procedures to prevent delays, carefully designing exemptions to minimize market distortions, and gradually expanding VAT coverage in alignment with rural development objectives. Continuous monitoring and evaluation of VAT policies are also essential to ensure their effectiveness over time.

The implementation of VAT in agriculture is a complex yet critical policy issue. When

appropriately designed and effectively administered, VAT can generate public revenue without adversely affecting agricultural production or food security. Achieving this outcome requires a careful balance between efficiency, equity, and administrative feasibility, while supporting the long-term development of the agricultural sector. In this context, a standard uniform VAT rate has been identified as a more effective mechanism for compensating income losses and maintaining neutrality within the tax system (Crawford et al., 2010).

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