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Impact of Moldovan Tax System on Local and Agriculture Sector Development: 25 Years of Experience and Challenges

Abstract: *Moldova's transition from planned to market economy required a total reconstruction of the tax system structure, particularly: taxes, tax administration and legislation of tax matters. However, in practice, Moldovan tax system (MTS) was not able to solve the multitude of problems that occurred. This system is unfair as it hampers economic growth, applying half measures, and does not ensure state programs and services are efficient especially on agriculture sector. The legal economy was substituted with "shadow one" that gets alarming proportions until present. The largest share in total informal employment holds agricultural sector, and the main contribution belongs to households. Due to the specificity of this type of employment, 80% of informally employed people are working in rural areas, which is detrimental for an economy where a*bout *55% of population lives in rural areas and almost 28% are employed in agriculture. The paper aims to reveal the weaknesses and strengths of MTS, related to development on agriculture sector, considering several suggestions for most appropriate taxing culture changes (e.g. personalized VAT reform based on successful experience of Latin America).*

Keywords: *Moldova, taxation, agriculture, tax system, tax policy.*

Introduction

Nowadays, the Moldovan agriculture receives highly favourable tax treatment for its high risks, low profitability, and high capital intensity[1]. However, taxation system of agriculture is still considered, by farmers, as a burdensome one. Moreover, according to our research they do benefit from such favourable tax arrangements. The annual cost of farming sector that benefits from tax arrangements is estimated at more than 0.6% of GDP, with the largest share being for VAT treatment, followed by direct taxes and social security contributions. Tax expenditure amounts to about 60% of tax collections (which represent less than 1% of GDP) in agriculture.

The evolution of the Moldovan tax legislation is largely detached from tax law theories and development. Moldovan tax law is influenced more by political reasons, rather than a well-thought approach of imposing economic aspects, which generates imperfections, multiple discrepancies, contradictions and deficiencies. Three administrative-territorial reforms[2] and other changes to local finances have caused considerable uncertainty and reduction in the weak Moldovan economy from an institutional point of view through contradictory or not logical legislative base.

Due to the territorial spread of the activity, large number of population involved[3], the necessity for state levies and given the vulnerability to exogenous shocks[4], agriculture is commonly rated the hardest to tax of all hard-to-tax

[1] In fact, we argue, that before the transition to market economy there was no tax system existed in the common sense. The state played a dual role in the system as a tax collector and tax payer, owning centralized banking system, which tracked *kolhoz* collective farm and *sovhoz* soviet farm transactions. Budget revenue were ensured by two primary sources: turnover tax on consumption goods and services was extremely low or negative (subsidies) on basic products, and very high on luxury goods, and *kolhoz* / *sovhoz* profits, classified as deduction of surplus product rather than profit taxes varying from 50 to 100%. However, without strict rules on deductible production costs, total tax liability becomes negotiable. Thus, the state adjusted arbitrarily tax structure and administrative procedures to meet budgetary requirements. Moreover, negotiable tax liabilities allowed state to exclude bankruptcy through collective and soviet farms tax relief request and generate lack of transparency within the system. The population was unaware of tax procedures or even of tax burdens. Only a few persons knew about them (director and superior economist). There were other taxes also (e.g. Personal Income Tax (PIT), considered undesirable to tax works directly and the payroll tax, designed to increase the effective price of labour) that did not play a significant role in centrally planned economies.

[2] In the analysed period (1990-2014) Moldova had three administrative-territorial reforms: 1994, country's territory was divided in 38 *raioane* (districts), including five in Transnistria and three in Gagauzia; 1998/1999, the districts were amalgamated in 10 *judete* (counties), accompanied by a significant administrative reform, with new division of competency and resources, as in Romanian model, returning to the pre-soviet administrative-territorial structures from sub-optimally small local governments, reinforcing self-administration; 2001/2003, new administrative-territorial reform adopted by the Communists, which took effect after the local elections in 2003. The current model of territorial reform was established, with significant reductions in local autonomy and was justified by the need to reduce the number of local government employees and to bring services closer to the people.

[3] About 55% of the population (3.5 million people) lives in rural areas and almost 28% are employed in agriculture.

[4] During its transformation, Moldova has faced four major crises (The economic, social and political crisis of 1989-1992, The Russian Financial Crisis of 1998, The global economic and financial crisis of 2008 and The Ukrainian and Russian crisis of 2014-present), each of which revealed the need for fiscal adjustment and, more importantly, for putting public revenue and expenditure on a long-term sustainable path.

sectors5. The difficulty of taxing agriculture is of major concern in countries like Moldova, where agriculture still accounts for relatively important share of GDP (more than 12%). Thus, taxing agriculture more effectively becomes central for development issue.

There is a number of steps countries can take to ensure that they collect an appropriate amount of tax from individuals or businesses operating in their jurisdictions. The paper aims to reveal the weaknesses and strengths of MTS, related to development on agriculture sector, considering several suggestions for the most appropriate taxing culture changes.

To this end, three main questions are addressed:
(1) What do we need?
(2) What do we see?
(3) How to move forward?

This research is relevant for three groups of addresses: governments and policy-makers, academic staff and researchers, and households and farm producers. The article focuses primarily on the situation faced by Moldova in the last 25 years. A large amount of data provided by World Bank, IMF, OECD, Main State Tax Inspectorates, Ministry of Finance information and other sources of technical expertise was collected, synthesised, and analysed.

Optimal formula of fair taxation

Moldova's transition from planned to market economy required a total reconstruction of the tax system structure, particularly: taxes, tax administration and legislation of tax matters. However, in practice, Moldovan tax system (MTS) was not able to solve the multitude of problems that occurred. This system is unfair as it hampers economic growth, applying half measures, and does not ensure state programmes and services efficiently, especially in agriculture sector.

Even though the ingredients of optimal formula are well known, Moldovan government and farmer's community are still looking for it. These ingredients represent the answer to our first question: **What do we need?**:

1. Transparent, simple and fair tax rules providing for sufficient revenue;
2. Compliant taxpayers willing and able to pay their fair share;
3. Effective tax mechanism giving farmers a certain advantage over agricultural products' importers either through less burdensome tax regime or by subsidizing some part thereof;

[5] The three hard-to-tax sectors are conventionally taken to be small business, services and agriculture, in ascending order of difficulty, although all components of the hard-to-tax are not necessarily small (Bird, 1983).

4. Efficient tax administrations that have the legislative tools and practical means to check the correctness of the taxpayers tax return, in order to stimulate the honest taxpayer and fight with incompliant one.

Transformation of Moldovan tax reforms

Based on the pace and direction of tax reforms as well as relative success of reform implementation, we can distinguish six stages of transformation (Criclivaia, 2015):

I – 1990-1991: the initial stage, where taxation was aimed to perform only the fiscal function of the system6, define the configuration of the MTS for an independent state.

The necessity for tax reform appeared in 1990. According to the Concept of the tax reform, MTS must provide a homogenous and fair attitude to all taxpayers, ensure a stable basis for state programmes financing and services development, structured to guarantee social and economic facilities for population and sectors of the economy.

Decision No. 68 on 7.03.1990 of the Council of Ministers of MSSR was the first important legal act that created a new body – State Tax Inspectorate, independent subdivision within the Ministry of Finance (MoF).

This stage is characterized also by implementation of the Concept of agrarian reform and social and economic development of the state (Law No. 510a of 19/02/1991) and by adoption of the Law No. 627-XII/1991 on the privatization, Law No. 459-XII/1991 on the property and Law No. 828/XII /1991 on the Land Code.

II – 1992-1994: the second stage was characterized by legalization of general principles of law, including taxation, and implementation of a control function.

Real tax reform started on 17 November 1992 with the adoption of the Law on the foundations of the state tax system that determined the economical, juridical and organizational aspects of MTS, provided types of taxes: VAT, Excises, CPT, PIT, Land Tax, Road and transit taxes, taxpayers' and authorities' obligations, rights, liability for infringements and fiscal accountability. This law ruled MTS for a decade up to enforcement of Title V of the Tax Code on 1 July 2002. On 2 December 1992 comes into force the Law on taxation businesses' benefit (CIT). All businesses – legal entities in Moldova, regardless

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[6] The beginning of this stage coincides with *perestroika* (reconstruction), transparency and acceleration launched by Gorbachev in early 1986 and Soviet Union collapse in 1991. The first step was taken in 1987-88 by introducing fixed "economic rates", where planed absolute amount of payments were transformed into fixed percentage rates.

of ownership forms and legal framework, including enterprises with foreign investments, international associations and organizations exercising entrepreneurial activity directly or through permanent representatives and subsidiaries were subject to this tax. However, due to the subject of our paper it has to be mentioned that the agricultural enterprises, except those of industrial type, do not pay the tax on the benefit derived from the agricultural activity.

Law on local taxes and fees No. 186-XIII/1994 also matters as tax related acts in this period. The introduction of local taxes, settlement of their amount, provision and facilities were charged by the local tax authorities, thus, establishing a flexible taxation system according to the needs and interests of communes, municipalities and districts.

III – 1995-1996: the MTS accelerated development stage, characterized by fiscal leverages' mechanism transformations, particularly by stimulating investment activity for production development, establishment of budgetary mechanism in 1996 in the Law on budget system and budget process and Law on budget classification, complication of tax system through a very impressive number of legal acts, e.g. the provisions on deductible business expenses demanded knowledge of the entire set of detailed rules. In 1996, there were 41 legislative acts in force regulating taxation of companies' benefits, including 11 laws, one parliamentary decision, three Decrees of the President, 7 Government's Decisions, 17 instructions and practical guides of the Ministry of Finance and Tax Inspectorate, a few instructions of the Department of Statistics, etc. One of the tax incentives of this stage for farmers was that of 1995, based on which agricultural enterprises started to pay a single land tax, which included real estate and road taxes, previously paid separately.

On the other hand, this stage was marked by:

– Different tax regime for imports and exports between former USSR and non-USSR members as well as among them in the Commonwealth of Independent States;
– Tax discrimination of domestic investors transformed Moldova, through undiscerning tax privileges granted, into an oasis for fiscal speculations and hidden business, i.e. for experienced tax fraud foreign companies.

IV – 1997-2005: – this stage is characterized by implementation of the Law No. 1217/1997 on the privatization programme for 1997-1998, Law on normative price and procedure on sale-purchase of land No. 1308-XIII/1997, new Fiscal Reform Concept and continuous MTS management improvements, such as National Accounting Standards, Government Decision on the tasks of the State Treasury, through adoption of: The ***Tax Code*** (1997-2001), which establishes tax rates and bases for domestic taxes; The Law on ***Customs Tariffs*** No. 1380-XIII/1997; The Law on ***State Social Insurance*** No. 489-XIV/1999; Law on ***Farms*** No. 1353-XIV/2000; Law on ***Entrepreneurial Cooperatives*** No.73/2001; Law on ***Local Public Finance***, No. 397-XV/2003. The Law

No. 243-XV/2004 on subventions of production risks in agriculture also has to play a role in the agricultural sector development.

The privatization of agricultural assets of the former collective farm enterprises was carried out massively in 1998-2001, and in many cases, with serious violations of legal regulations. In addition, a large part of the capital was destroyed greatly due to a lack of transparency in the privatization process, biased legislation and group interests embodied in buying assets at extremely low prices. These factors decisively influenced the liquidation of enterprises that could be restructured and privatized. The process of privatization has resulted in a highly fragmented structure of land ownership. Thus the land privatization process produced over 1 million of new landowners (World Bank, 2016). Moreover, a large degree of heterogeneity in the characteristics and performance of agriculture producers has been established which lasted until present time. According to the data from the 2011 Agricultural Census, there are about 900,000 farms in Moldova, with an average size of 2.5 hectares (World Bank, 2015)7.

However, privatization brought different possibilities for property income (e.g. interest, dividends, annuity, income from sales of the property) to their owners, which ultimately gave more revenue tax sources to the government. Thus, since 1999 a considerable increase in transactions for the sale of agricultural land and land rent benefits can be observed. Trends and dynamics of this process are reflected more accurately in the evolution of market prices for agricultural land. If, at the beginning of sale transactions, the market price of a hectare of farmland in Moldova was MDL 3364 (in 1999), the average price for 2015 reached MDL 19,851 per ha or 5.9 times more (current prices). In some regions (e.g., Mun. Chisinau and suburbs), the market price of agricultural land is MDL 100 thousand per ha and more. Currently, more than 50% of total agricultural land is used under the lease relation system, thus performing the land consolidation function as well.

<u>**V – 2006-2010:**</u> this stage of improvement of national legislation focused on tax administration and fiscal reporting and favourable investment environment.

The main challenges of the period are:
– Law No. 111-XIV/2007 on ***fiscal amnesty*** cancelling all tax debts until 01.01.2007,
– The Tax Code set the ***CIT rate to zero %*** entering into force on 01.01.2008,
– Law No. 111-XIV/ 2007 on ***capital legalization***.

[7] 88% of producers engaged in fruit production (nearly 400,000) have holdings of less than 0.1 hectares. Another 9% (just over 40,000) have holdings between 0.1 and 0.5 hectares. At the larger end of the spectrum, fewer than 1,000 farmers have holdings of 10 hectares and more. Of these, 115 farmers have holdings of more than 100 hectares.

– Strategy for attracting investments and promoting exports for 2006-2015 granted ***many tax and customs facilities***,
– New ***Title IX "Road Taxes"*** was added to the Tax Code.

This stage was also characterized by many tax exemptions for the farmers. Thus, for the 2006-2010 period, farmers were exempted on corporate income tax (CIT), real estate tax, road taxes, fee for water abstracted by farmers[8].

<u>VI – 2011-present:</u> this stage aimed to develop MTS into a modern efficient European tax system. In this context the actions consisted in:

- Continuation of reform of tax system, ***bringing VAT and excise legislation in line with the EU acquis and international requirements***, to reach the minimum EU rates by 2025.
- ***Reduction and/or elimination of import duties*** starting in November 2014.
- ***Annulment of almost all tax facilities and reintroduction of 12% CIT*** since 2012. In 2014, the government decided to reintroduce some exemptions, including the exemption of farmers from VAT on imports as well as from VAT within the country on sale of tractors, agricultural machinery and irrigation equipment. However, according to the requirements/suggestions of World Bank (World Bank 2016) these incentives will be removed soon.
- ***Establishing more cooperative and collaborative relations*** (agreements with the Swedish Tax Agency, the French General Directorate of Public Finance, the Dutch Tax and Customs Administration, and the Estonian Tax and Customs Board and others). Foreign donor agencies play an important role in the national economy. A large number of international donors and donor organizations such as USAID, TACIS, SIDA, DFID, Soros Foundation, organizations from Japan, Poland and the Netherlands, have recently become more active in supporting agricultural activities, including through investments, grants, low interest rate loans and bank guarantees, through technical assistance.
- ***Fight against tax evasion and avoidance***. Institutional framework registered many changes during the last 25 years as regards control and sanction functions of tax violations. In 1990, it was attributed to state tax inspectorates, then in 1991 to Financial Guards that was transferred to the Centre for Combating Economic Crimes and Corruption (in 2002). After 10 years it was passed to the Ministry of Internal Affairs and due to amendment of the Tax Code on 01.01.2014 it comes back to the tax authorities. Thus, the above-mentioned changes were inefficient, confirmed by growing ratio of tax evasion to GDP that was 4.5% in 1994, 43% in 2010 and about 50% estimated in 2014. For this reason ***this stage of MDS transformation is focused on fighting against tax evasion and avoidance*** to eliminate duplication of the functions of control, ensure transparency and cost efficiency for all involved parts. Thus, the Criminal Code introduced Article 244 and 244^1, the Contravention Code – Article 301, Tax Code – Chapter 11^1 – Indirect Methods of estimation of individuals'

[8] Law No. 261 of 27.10.2005 on amending and supplementing certain acts, Official Gazette No.157-160, Article 782, effective date: 01.01.2006.

taxable income, Convention on Mutual Administrative Assistance in Tax Matters signed in 2011, etc. The biggest area of tax evasion is represented by VAT frauds. Some sectors (one of them is agriculture), where there are numerous tax exemptions and a greater diversification of VAT rates, pull, in fact, government money on a net basis. It is, therefore, necessary to further review the VAT framework to stop any leakage of resources in such a way.

- ***Fiscal decentralization strategy*** aiming at improving the quality and delivery of public services (setting new rates for sharing national taxes with the two tiers of local government, introduction of formulas for transfers to local governments and removal of subordination in financial relations between top and bottom-tiers of local government).

Generally, we consider the last period as the most relevant to Moldova's needs as regards the Taxing Culture Change and results will not hesitate to come.

Development of the main taxes

The contribution of agriculture to the state budget is smaller than its share in GDP (less than 1%). The main components of the existing taxation system are: land tax, income tax, VAT and excise duties, and social security contributions. Farmers and agricultural producers are forced to pay also other taxes, such as water tax, real estate tax, customs tariffs, etc.

a. Personal Income Tax (PIT)

During all 25 years of transformation, the personal income tax system maintained a progressive rate structure with the number of brackets ranging from 2 to 7 and tax rates from 7 to 50%. Initially, Moldova had numerous exemptions and deductions from PIT that included various benefits, in-kind allowances and interest income, however, later on (see table 1) the national tax authority initiated changes in the PIT system with the view to broadening and simplification of the rate structure.

The PIT was withheld by the employer and transferred to the budget. For this reason, individuals were not required to declare income[9]. Nowadays, all individuals are subject to PIT. There are 2 income brackets and 18% is the highest rate, and the minimum rate is 7% for the income of not more than MDL 27,852. All taxpayers are entitled to file the income tax return with some exceptions[10]. Thus, the taxpayer is required to file an income tax return not later than by 25 March after the end of the tax year, which coincides with the calendar year[11].

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[9] Only individuals who obtain income from self-employment were required to submit tax returns.

[10] Tax Code, Article 83.

[11] It has to be noted that mandatory taxpayers' obligation to file a tax return occurred for the first time after 1998. Moreover, during 1999-2014 period, the term to file the income tax return was not later than 31 March after the end of the tax year.

It should be noted that numerous alterations to PIT system did not result in substantial changes of PIT revenues in terms of GDP, mostly because of low compliance and other exemptions. This revenue source amounted to between 1.6% and 2.8% of GDP (figure 2).

The proposed measures to the PIT are to support low-income persons and gradually shift the tax burden to families with average and above average incomes. Thus the progressive system of PIT is kept during all years of the analysed period. Since 2010, the increase of instalments of taxable income, personal exemption, major exemption and exemption for dependents has been subjected to inflation rate.

Table 1. Moldova: main changes in PIT system, 1990-2015

1992	Law on PIT adopted with 7 income brackets (10%, 15%, 20%, 25%, 30%, 35%, 40% and 50%)
1995	Law enacted 6 brackets (10%, 15%, 20%, 30%, 40% and 50%)
1996	Law enacted 5 brackets (10%, 15%, 20%, 30%, and 40%), min. rate 10% for income < 3 minimal wages (min. wage MDL 187)
1997	New Tax code set two PIT rates of 20% and 32%[12]
1998	Tax code enacted 3 brackets (ti<6000 – 15%, 16,200<ti<10,800 – 20%, ti>10,800 – 32%). Exemptions introduced (personal exemption – MDL 2,100, major personal exemption – MDL 10,000; exemption for dependents – MDL 120) and income threshold raised to MDL 10,800[13]
1999	PIT rates were reduced to 28%, 15% and 10%
2001	Min. income threshold was raised (ti<12,180 – 10%, 12,180 <ti<16,200 – 15%, ti>16,200 – 28%)
2003	PE and ED were raised to MDL 3600 and MDL 240, respectively
2004	Max. rate was reduced to 22%, income brackets and exemptions remained the same
2005	PIT rates were reduced to 20%, 14% and 9% (ti<16,200 – 9%, 16,200<ti<21,000 – 14%, ti>21,000 – 20%). PE and ED were raised to MDL 3960 and MDL 600, respectively
2006	PIT rates were reduced to 20%, 13% and 8%, income brackets remained the same. PE and ED were raised to MDL 4500 and MDL 840, respectively
2007	PIT rates were reduced to 20%, 10% and 7%, income brackets remained the same. PE, MPE and ED were raised to MDL 5400, MDL 12,000 and MDL 1440, respectively
2008	Income brackets were reduced to two, max. rate was reduced to 18%, min. rate at 7% was valid to 2015; PE and ED were raised to MDL 6300 and MDL 1560, respectively, and income threshold was also raised to MDL 25,200
2009	PE and ED were raised to MDL 7200 and MDL 1680, respectively
2010	PE, MPE and ED were raised to MDL 8100, MDL 12,000 and MDL 1800, respectively
2012	PE, MPE and ED were raised to MDL 8640, MDL 12,840 and MDL 1920, respectively; Additional chapter 11 was added to Tax Code – Indirect methods of estimation of Individuals' taxable income
2013	PE, MPE and ED were raised to MDL 9120, MDL 13,560 and MDL 2040, respectively, and income threshold was also raised to MDL 26,700
2014	PE, MPE and ED were raised to MDL 9516, MDL 14,148 and MDL 2124, respectively, and income threshold was also raised to MDL 27,852
2015	PE, MPE and ED was raised to MDL 10,128, MDL 15,060 and MDL 2256, respectively, and income threshold was also raised to MDL 27,852

ti – taxable income

Source: elaborated by the author based on STS Reports.

[12] Law No.1218-XII from 3.12.1992 on Personal Income Tax, Official Gazette, No.12, 30.12.1992. Repealed on 01.01.1998 with effect from the entry into force of Title I and II of the Tax Code.

[13] Abbreviation used: personal exemption (PE); major personal exemption (MPE); exemption for dependents (ED); Moldovan Leu, national currency (MDL).

b. Corporate Income Tax

All economic entities from Moldova were subject to the Corporate Income Tax (CIT), regardless of the form of ownership and legal framework, enterprises with foreign investments, international associations and organizations exercising entrepreneurial activity directly[14] or through a permanent establishment and subsidiaries.

Table 2. Moldova: main changes in CIT system, 1990-2015

1992	Law[14] on CIT adopted with tax rate of 32% for most companies and 1.5% -55% for special cases, exemptions and tax holidays for agriculture related activities and joint ventures
1997	New Tax Code unified CIT rates at 32% and eliminated many special tax exemptions, benefits for agriculture related activities and joint ventures remained
1999	CIT rate was reduced to 28%
2002	CIT rate was reduced to 25%
2003	CIT rate was reduced to 22%
2004	CIT rate was reduced to 20%
2005	CIT rate was reduced to 18%
2006	CIT rate was reduced to 15%
2008	CIT rate was set to zero percent; Regulation determining tax liabilities on income tax was adopted.
2207	Reporting period for the losses in the future on CIT increased from 5 to 3 years
2012	CIT rate was reintroduced to 12% for companies, 7%/18% – individual entrepreneurs and *7% – Farmers*, cancelling all general and individual tax incentives, except those guaranteed for a specific time: free economic zones, interest on bank deposits and corporate securities as bonds; A single simplified 3% CIT of revenues from the operational activity of small- and medium-sized enterprises (non-VAT payers) was enacted; Reporting period for the losses in the future on CIT was reduced from 5 to 3 years.

Source: elaborated by the author based on STS Reports

In the early 1990s, the CIT system in Moldova had multiple rates varying widely for specific cases and sectors from 1.5% to 55% (with a general rate of 32%), with numerous exemptions and incentives for foreign investment. Characteristic for this period was the progressive method used for taxing corporate profits[15]. In 1997, Moldova moved towards rationalization of rate structures and unified rates at 32%. Since then the overall trend was toward a reduction in CIT rates between 32% and 0% from 1997 to 2008. The CIT rate at 12% was introduced in 2012, being maintained until the present time. Thus, since 2012, according to the Tax Code, Moldova applies Income Tax Rates[16] as follows: (a) for physical persons and individual entrepreneurs – 7% and 18%; (b) for legal persons – 12% from taxable income; (c) ***for Farmers – 7% from taxable income***; (d) for economic entities whose income was estimated in accordance with Article 225 and Article 225 – 15% of the surplus of the estimated income compared to the gross income registered in the accounting system of the economic agent (table 2).

[14] Law of Republic of Moldova No. 1214-XII of 02.12.1992, on Corporate Profit Tax, Official Monitor, No.1, 30.01.1993. Abolished on 01.01.1998, with the entry into force of Title I and II of the Moldovan Tax Code.

[15] Max. rate 70%, min. rate 32% for profits < level of profitability set by the government.

[16] In order to distinguish Income Tax for Legal persons from Income Tax for individuals and others we will use the CIT concept.

Households and economic entities – farm producer, which are obliged to pay CIT in income instalments, have the right to pay it in two stages. First – 1/4 of the CIT – up to 30 September. Second – 3/4 of this amount – up to 31 December.

Statistics show that an essential reduction in the CIT rate, many exemptions and tax holidays (e.g. households were exempted from CIT for a period of 3 years during more than 15 years (Article 49(1) of the CF)[17], economic entities – farm producers for a period of 5 years (from 01.01.2006 to 31.12.2010)) did not achieve its goal to stimulate investments and legalize illicit incomes in agriculture sector, which ultimately was expected to help raise the needed budget revenues. In order to revamp incentives to invest in agriculture and provide income support to the poorest farmers, the World Bank suggested to increase the rate for agricultural enterprises to the standard 12% and introduce a presumptive turnover-based tax (World Bank, 2016).

c. Social security and mandatory health insurance contributions (SC and MHIC)

Social and health insurance contributions are a substitute of the payroll taxes system. In order to establish a reasonable tax burden both for the employer and for the employee, SSCs and MHICs were reviewed throughout the period. The evolution of social and health contribution rates are presented in Table 3 and 4.

Table 3 shows a huge difference between general SSC (from 30% in 2002 up to 29% in 2015) and SSC paid in agriculture (from 29% in 2002 up to 6% in 2015) as well as between the fixed sum required from individuals (MDL 2013 in 2006 up to MDL 6372 in 2015) and landowners and tenants of farmland who work the land individually (MDL 525 in 2002 up to MDL 1584 in 2015).

The size of the contribution of landowners and tenants of farmland, who work the land individually, does not depend on the area of agricultural land. The contribution in question allows the taxpayer to benefit from the minimum pension and death benefit.

According to the data from table 4 we can see that owners of agricultural land and other individuals are entitled to application of 75% discount for the amount of the MHI contribution set out in the fixed sum if this sum is paid within 3 months from the date of entry into force of the law on Mandatory Health Insurance.

[17] On the expiry of 3-year exemption, the above-mentioned businesses are entitled to a 35% reduction of income tax rates within two years (Article 49 point 10 of the CF).

Table 3. Moldova: main changes in SSCs system, 1990-2015

	Social Security Contributions
1999	Law on social insurance system No. 489-XIV of 08.07.1999 adopted with SSC rate at 32% (paid by employer and employee at the rate of 29% and 1%, respectively). Pension reform.
2002	SSC rate reduced to 30% (paid by employer and employee at the rate of 29% and 1%). For land owners, that are passed for rent; for landowners organized in collective associations for processing of land; for individuals and companies that rent farmland based on a contract – MDL 1.7 annually for a unit grade/hectare and 29% in labour remuneration fund and other rewards under individual labour contracts for each employed person. For ensuring landholder (of each founder) who does not owns their own agricultural land – MDL 525 annually
2004	SSC rate at 30% (paid by employer and employee at the rate of 28% and 2%, respectively)
2005	SSC rate reduced to 29% (paid by employer and employee at the rate of 27% and 2%)
2006	SSC rate 29% (paid by employer and employee at the rate of 26% and 3%) or fixed sum for individuals (MDL 2013) and tenants of farmland and landowners who work the land individually (MDL 1795)
2007	SSC rate at 29% (paid by employer and employee at the rate of 25% and 4%) or fixed sum for individuals (MDL 2318) and tenants of farmland and landowners who work the land individually (MDL 576)
2008	SSC rate at 29% (paid by employer and employee at the rate of 24% and 5%) or fixed sum for individuals (MDL 2920) and landowners and tenants of farmland who work the land individually (MDL 725)
2009	SSC rate at 29% (paid by employer and employee at the rate of 23% and 6%) or fixed sum for individuals (MDL 3708) and landowners and tenants of farmland who work the land individually (MDL 920)
2010	SSC rate at 29% (paid by employer and employee at the rate of 23% and 6%) or fixed sum for individuals (MDL 4044) and landowners and tenants of farmland who work the land individually (MDL 996)
2011	SSC rate at 29% (paid by employer and employee at the rate of 23% and 6%) or fixed sum for individuals (MDL 4368) and landowners and tenants of farmland who work the land individually (MDL 1080)
2012	SSC rate at 29% (paid by employer and employee at the rate of 23% and 6%) or fixed sum for individuals (MDL 4704) and landowners and tenants of farmland who work the land individually (MDL 1164)
2013	SSC rate at 29% (paid by employer and employee at the rate of 23% and 6%) or fixed sum for individuals (MDL 5220) and landowners and tenants of farmland who work the land individually (MDL 1296)
2014	SSC rate at 29% (paid by employer and employee at the rate of 23% and 6%) or fixed sum for individuals (MDL 5748) and landowners and tenants of farmland who work the land individually (MDL 1428)
2015	SSC rate at 29% (paid by employer and employee at the rate of 23% and 6%) or fixed sum for individuals (MDL 6372) and landowners and tenants of farmland who work the land individually (MDL 1584)

Source: elaborated by the author based on National Social Insurance Agency data.

The proposed measures aim to strengthen the financial stability of the social security system and to expand public health services packages offered through Mandatory Health Insurance Contributions. However, the Wold Bank suggested to reconsider current tax incentives for private pension saving and consider removing the reduction in the SSC rate for farmers in order to revamp incentives to invest in agriculture and provide income support to the poorest farmers (World Bank, 2016).

Table 4. Moldova: main changes in MHICs system, 1990-2015

	Mandatory health insurance (MHI) Contributions
1998	Law No. 1585-XIII of 27.02.1998, on Mandatory Health Insurance
2002	Law No. 1593 on Amount, Procedure and Terms of MHI Contribution Payment
2004	Mandatory health insurance system implementation. MHICs rate at 4% (paid by employer and employee at the rate of 2% and 2%). The fixed sum (MDL 441.2) set for owners of agricultural land and other individual taxpayers
2006	The fixed sum (MDL 816 set for owners of agricultural land and other individual taxpayers
2007	MHICs rate increased to 5% (paid by employer and employee at the rate of 2.5% and 2.5%). The fixed sum (MDL 1209) set for owners of agricultural land and other individuals
2008	MHICs rate increased to 6% (paid by employer and employee at the rate of 3% and 3%) First time application of 50.0% discount for the amount of MHI contribution set in fixed sum (MDL 1893.6)
2009	MHICs rate increased to 7% (paid by employer and employee at the rate of 3.5% and 3.5%). First time application of 50.0% discount for the amount of the MHI contribution set in the fixed sum (MDL 2637.6) for owners of agricultural land and other individuals
2010	First time application of 75.0% discount for the amount of the MHI contribution set in the fixed sum (MDL 2772) for owners of agricultural land and other individuals
2012	MHICs rate at 7% (paid by employer and employee at the rate of 3.5% and 3.5%). Application of 75.0% discount for the amount of the MHI contribution set in the fixed sum (MDL 2982) for owners of agricultural land and other individuals
2013	The fixed sum (MDL 3318) set for owners of agricultural land and other individuals
2014	MHICs rate increased to 8% (paid by employer and employee at the rate of 4% and 4%). The fixed sum (MDL 4056) set out for owners of agricultural land and other individuals
2015	MHICs rate increased to 9% (paid by employer and employee at the rate of 4.5% and 4.5%).

Source: elaborated by the author based on National Health Insurance data.

d. Value Added Tax[18]

VAT was intended mainly to hit consumers, but in reality this tax has proved to be particularly burdensome for economic units creating a financial system which was in a disastrous state, disfavouring their development. The introduction of VAT at 28% in 1992 was unsuccessful. As a result it was reduced to 20% in 1993, being maintained until the present[19] (table 5).

Along its long way of transformation, the VAT system underwent many changes, especially after following the 2005 EU-Moldova European Neighbourhood Partnership Action Plan. The proposed measures to VAT were turned to support production and gradually shifted the tax burden on population. During the period of transformation many exemptions and VAT incentives were granted and ultimately eliminated, at the same time increasing the registration threshold for VAT payers. As a result, an important share of tax revenue growth is based on a decrease in VAT refunds, which is not a part of the competitive and sustainable economy growth action plan. Nevertheless, some improve-

[18] The tax on goods' circulation and sales, which had about 143 of allowances was replaced by VAT by way of the Presidential Decree regarding Value Added Tax, No. 257 of 27.12.1991. The tax on goods' circulation and sale use to be applied depending on the organizational and legal form and property type of entity and/or depending on the specific branch of the relevant companies. Fiscal policy in relation to tax on goods' circulation and sales did not play a regulatory role in the economy; planned management was incompatible with such a role.

[19] Tax Code, Article 96.

ments as regards simplification of VAT refund procedures can be found during the last 5 years. Thus, it has extended the VAT reimbursement amounts credited to a wider range of transactions[20], starting over the process of stimulating real economy.

Besides all of the above, the introduction of "personalized" VAT reform, could have significant poverty and shadow economy reduction effect while enhancing neutrality, equity and simplicity, which favours administration. Some researchers (Carbacho et al., 2013; Berrex et al., 2010b and 2012) found a solution to "the Impossible Trinity of a consumption tax, which requires a broad base, a uniform rate and relief for poorest taxpayers". These solutions, have been successfully applied for 15 years in Latin America. According to them:

– All exemptions and lower rates have to be removed and monetary compensation to correct the regressive effects of VAT for a particular group of taxpayers has to be implemented;
– The exclusions from the tax base and differential treatment strengthening the neutrality and efficiency of the tax by reducing the cascade effect have to be limited;
– Generalization of VAT facilitates tax administration and promotes formality by using electronic payments;
– The determination of the refund amount has to be based on objective criteria;
– The proposal has to be tailored to the conditions of informality and levels of institutional development of public administration, thus to minimize the potential for manipulation and patronage.

The most used tax incentives by the agricultural enterprises are reduced tax rate (table 5) and possibilities not to pay VAT in case of annual amount received from the taxable deliveries of goods/services (except imported goods/services) is valued at less than MDL 100,000 in 12 consecutive months. These possibilities lasted since VAT implementation and there is no secret that many households and farmers used them to avoid tax.

Thus the Wold Bank suggested to remove the VAT exemption for agricultural machinery and re-introduce a unified VAT rate for agriculture products combined with compensation for low-income households in order to revamp incentives to invest in agriculture and provide income support to the poorest farmers (World Bank, 2016). The proposals for 2016 include the requirement for all businesses to register as VAT and gradual exclusion of a number of existing forms of fiscal incentives for businesses and individuals from the Tax Code.

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[20] According to 2014 STS Report over the past 5 years (2010 to 2014) the amount of the VAT refund doubled from MDL 1058.3 to MDL 2375.5 million.

Table 5. Moldova: main changes in VAT system, 1990-2015

1991	Presidential Decree on VAT
1992	VAT adopted with a standard rate of 28%, using the origin principle in the trade within the CIS
1994	Law on VAT standard rate reduced to 20% and a zero rate enacted.
1995	Law required VAT to be based on invoices, introduced destination principle except for trade with Russia
1997	Law on Application of Title III “VAT” of the Tax Code
1999	Reduced rate of 8% introduced for selected food items and 5% for natural gas
2003	Compulsory registration threshold for VAT payers raised from MDL 100,000 to MDL 200,000
2004	Tax incentives excluded for certain goods and raw materials used in agriculture and for equipment and complementary aggregates, except for those used in manufacturing of agricultural production. Measure was extended in 2005.
2006	Selected medical drugs were moved to the reduced rate (8%) group
2007	Compulsory registration threshold for VAT payers raised from MDL 200,000 to MDL 300,000 and a special provision for VAT payers’ registration threshold to MDL 100,000 was introduced
2008	Selected other medical items were included in the reduced rate (8%) group
2010	Sugar and selected plants and animals were moved to the reduced rate group (8%); Amendments on VAT refunds enacted; Reduced VAT rate increased for liquefied and natural gas from 5% to 6%.
2011	Compulsory registration for VAT invoices, whose value is exceeding MDL 100,000; Compulsory registration threshold for VAT payers raised from MDL 300,000 to MDL 600,000; Extension of the VAT refund provisions for investments (expenses) incurred for farm tractors.
2012	VAT exemption for wind energy generating sets; Cancellation of VAT exemption to fixed assets invested in social capital; Sugar was moved to the standard rate group (from 8% to 20%); min. threshold raised to the category of assets that are deposited into the social capital without paying VAT (ordinary customs duty), from MDL 3000 to MDL 6000.
2013	Regulations on VAT refund adopted; Selected plants and animals were moved to the standard rate group (from 8% to 20%); Reduced VAT rate increased for liquefied and natural gas from 6% to 8%.
2014	Reintroduction of VAT exemption to fixed assets invested in social capital; Extension of the VAT refund provisions for companies providing passenger transportation services and not registered as VAT payers; Phytotechny, horticulture, animal breeding and sugar beet, produced, imported and/or delivered in the Republic of Moldova were moved to the reduced rate group (8%).

Source: elaborated by the author based on the Moldova Ministry of Finance, Medium-Term Expenditure Framework (MTEF) and STS Reports.

e. Excises

Excises were introduced in 1992. The list of goods subject to the excise duty, including a range from 20 to 60 categories, did not undergo big changes during the analysed period (table 6). Both expansion of the Goods List, subject to excise duty, and additionally, their exclusion is dictated by existing economic fluctuations, which determine the inclusion or exclusion of the targeted categories. Excise fiscal facilities granted did not influence the total excise duty given its maintenance without amendments.

As regards the excises structure, it has to be noted that during the first 10 years the highest share was owned by excises collected from wine from grapes, cognac and champagne, and tobacco products. Since 2000, the excises derived from petroleum products represent the biggest part, followed by tobacco production, cars and alcoholic beverages.

Moldova: main changes in excise duty system, 1990-2015

1992	Presidential Decree on Excises
1994	Law on excise duties adopted in percentages applied to the selling price
1995	Excise duties were established in fixed rates in monetary expression for a unit of goods subject to excise duty.
1997	Introduction and further increase in the rate of excise duty on wines raw materials for wine production.
1998	Fixed single rate of excise duty enacted for both domestic and imported goods. Expansion of Goods List with cars and coffee beans, ground coffee and instant coffee, fur, televisions, tape recorders, video recorders, furniture, office furniture, household and luxury, caviar, red caviar, perfumes; Increase in excise duty on beer, cigarettes and cigars, diesel, petrol.
2000	Law on Application of Title IV “Excise Duties” of the Tax Code. Since 1 May 2000, for all goods (production) subject to excise duty the same units are applied and positions are allocated according to the tariff classification of goods of the Republic of Moldova.
2002	Expansion of Goods List with petroleum derivatives
2004	Established ad valorem percentage share of value market for cognac, vodka, whiskey, rum, brandy and liqueurs (previously was absolute amount per unit of measure).
2005	Expansion of Goods List with ethyl alcohol derivatives
2006	Exclusion from Goods List of license for gambling; Increase in excise duty on tobacco products and spirits and decrease of those with less alcohol
2008	Adjustment to the inflation projected rate of excise duties paid in fixed amounts, except fuels. Measure planned to be kept till 2017; Gradual adjustment of excise taxes on tobacco products to the countries of the region and the European practice; Excise duty on filter cigarettes for both the domestic production and for the import adopted the tax base to the maximum price for retail sale; Review of excises quotes for goods that do not meet the World Trade Organisation requirements (e.g. caviar, perfumes, etc.).
2010	Expansion of Goods List, with crystal items; Increase in almost all goods, subject to excise duty.
2012	Exclusion from Goods List of crystal items; Expansion of Goods List with imported fuel oil, liquefied gas, nitrogen and oxygen imported; Exemption from excise duty on confiscated property, ownerless property, ownership pass based on succession and treasures rules; Increase in excises quotes for cars (about the 50%) with some exceptions.
2013	Exclusion from Goods List, subject to excise duty of wine from fresh grapes and grape must.
2014	Exclusion from Goods List of alcohol and their derivatives, which are used in food and non-food industry and precious metals; Excises structure changed for alcohol production from the combined quota to specific rate, along with their increase; Expansion of Goods List with other tobacco and manufactured tobacco substitutes tobacco “homogenised” or “reconstituted”, tobacco extracts and essences; Increase in excise duty on cars with service term more than 7 years.

Source: elaborated by the author based on the Moldova Ministry of Finance, Medium-Term Expenditure Framework (MTEF) and STS Reports.

It has to be mentioned that currently, the amendments to the excises chapter were made in line with harmonization and in accordance with the legal framework timetable established under the Association Agreement between the EU and the European Atomic Energy Community and Member States, on the one hand, and Moldova, on the other. Statistics show an increase in tobacco and fuel excises in line with Moldova’s commitment of narrowing the gap between regional levels and the EU average. As a result, since 2010 there has been an increase in excises in total tax revenue with almost one per cent of GDP (figure 2).

In the medium and long term, the authorities intend to continue the process of gradual harmonization of the excise tax rates with the EU minimums. Unfortunately, not all EU requirements take into account Moldova’s reality. According to the EU practices, the car taxation system is scheduled to be revised by

Table 7.

cancelling the excise duty (depending on CO_2 emissions) in the near future, which will probably have a negative impact on low and medium level income parts of population.

f. Real Estate Tax

Over the years, the land tax has undergone some changes. The payers of this tax were individuals and legal persons – owners, holders or beneficiaries of land. Initially, the tax rates were insignificant and differentiated, depending on the classification and fertility level of the land. Since 1995, agricultural enterprises have started to pay a single land tax, which included real estate and road taxes, previously paid separately. Consequently, land tax rates have been increased. Real estate tax, according to the President's Decree, began to be paid by all legal persons with fixed production and unproductive funds as well as by the citizens – owners of buildings and constructions.

Currently, notwithstanding Title VI of the Tax Code, land tax and real estate tax is calculated separately. In the real estate development process separation of tax base – land and improvements on them – generated legal and administrative issues. Imputing the fairness of the tax base was necessary to improve the evaluation system and subsequent unification of these taxes in a single tax (table 7). In case of the payment of both land tax and real estate tax before 30 June, all taxpayers (including households and economic entities – farm producers) benefit from a discount of 15% of the tax to be paid.

The first attempts to change the taxation system of real estate were taken in 1999 by introducing progressive coefficients depending on the total area of the main housing and constructions of individuals not engaged in entrepreneurial activity and registered ownership right. Statistics show the highest level of tax collected in GDP for this year followed by a huge decline until the present. Thus, increase in the tax burden on wealthier citizens did not have the expected positive impact, although it has burdened work and cadastral bodies with maximum tax inspectorates.

Nevertheless, implementation of new real estate tax system based on real estate value estimated at market prices started recently is expected to play a significant role in the near future. In order to incentivize better use of land, the World Bank proposed to:

- Abolish or ease the restriction on land acquisition by foreigners;
- Continue effective valuation of land and property and adopt value-based taxation property;
- Introduce a special tax on uncultivated land.

Moldova: main changes in real estate tax system, 1990-2015

1992	Law on land tax and taxation method. President's Decree on real estate tax
1995	Single land tax adopted for agricultural enterprises
1999	Progressive coefficients introduced. For large properties (with surfaces comprised between 100 and 150 square meters) the tax rate was 1.5 times bigger (with surfaces comprised between 150 and 200 square meters), 2 times bigger (with surfaces comprised between 200 and 300 square meters), 10 times bigger and for very large real estate (more than 300 square meters) it was 15 times bigger.
2000	Law on Application of Title VI "Real Estate Tax" of the Tax Code, Real estate tax adopted with 0.1% of the property's book value for entrepreneurial activity, for non-residential properties ranged between 0.1% and 0.3% of the property's book value, depending on their location.
2007	New real estate tax system implementation based on real estate value estimated at market prices; The first phase is related to housing (apartments and private houses, land relating to the property) in cities and towns, including towns that are part of them, except villages (communes).
2010	The second phase is related to garages and land on which they are located; fruit-growing associations' consignments with or without citizens' constructions placed on them and real estate of the economic entities used for commercial and industrial purposes. Real estate tax increased from 0.02% to 0.25%. For large properties (with surfaces comprised between 100 and 200 square meters), the tax rate is 3 times bigger, and for very large real estate (more than 200 square meters), it is 28 times bigger.
2012	New Real Estate rate for housing – apartments and private houses in villages (communes) related to Chisinau and Balti, in the amount of 0.05% (minimum rate) and 0.3% (maximum rate) and land farm with buildings located on them, in the amount of 0.1% (minimum rate) and 0.3% (maximum rate); Real estate tax increased to 0.05% (minimum rate) and 0.3% (maximum rate) for housing (apartments and private houses, land relating to the property) in cities and towns, including towns that are part of them, except the villages (communes) and garages and land on which they are located; fruit-growing associations' consignments with or without citizens' constructions placed on them and real estate of the economic entities used for commercial and industrial purposes; Cancellation of provision related to the taxation of real estate with a grade of less than 50% completion. Thus, following the proposed changes to be taxed all real estate estimated market value regardless of their degree of completion.
2013	Expanded list of categories of taxable items. Land tax and real estate tax is calculated separately for each category.

Source: elaborated by the author based on the Moldova Ministry of Finance, Medium-Term Expenditure Framework (MTEF) and STS Reports.

Since 2016, Moldova will change the current system of real estate evaluation. All property owners will be forced to evaluate their assets, and thereafter every three years – to re-evaluate them. Specialized companies authorized by the landlord will carry out the evaluation. It involves additional costs for owners for the benefit of the evaluators, but those who will not comply with this requirement, risk fines of up to MDL 100 thousand and a tax three times higher.

Impact of MTS on local and agriculture sector development

Moldovan tax reforms generally correspond to the "flat-rate tax" approach, based on simplification and aligning the *de jure* tax burden with the *de facto* administration capacity.

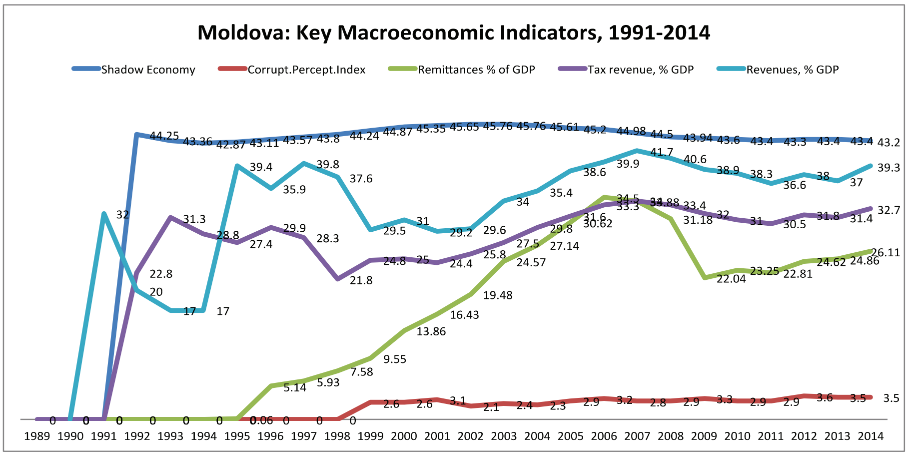

Figure 1. Moldova: Key Macroeconomic Indicators, 1991-2014

Source: elaborated by author based on the Moldova STS, World Bank, Transparency International and Elgin and Oztunalz (2010) data.

An increase in tax payments in 1990-1995 was caused mainly by high inflation[21]. In 1996, this reserve is exhausted, while reduction of GDP and tax evasion continued their pace. Reform, started in 2000, reducing tax rates without reducing revenue, by broadening the tax base and reducing the number of exemptions. It is widely seen as helping to:

– *Accelerate GDP*. The cumulative decline in GDP of 65% between 1990 and 2000 turned Moldova into the poorest country in Europe, which has lasted until present time.
– *Combat corruption*. Moldova score of public-sector corruption below 3 on a scale of 0 (highly corrupt) to 10 (very clean). This problem is evident just analysing subsidies' allocation among farmers. Most of them is allocated to a relatively small number of beneficiaries (over 80% of resources are allocated to less than 10% of beneficiaries) (Budianschi et al., 2012).
– *Reduce shadow economy*. The average rate of the shadow economy in Moldova is 44.4% during the analysed period. The largest share in total informal employment holds agricultural sector (66.4% in 2012), the main contribution belongs to households (1/3). Agriculture is one of two sectors where informal employment exceeds the formal one (74% in 2012) (Budianschi et al., 2012). Due to the specificity of this type of employment, 80% of informally employed people are working in rural area, which is detrimental for an economy where about 55% of population lives in rural areas and almost 30% are employed in agriculture.
– *Reduce poverty*. According to the World Bank data the highest poverty rates are registered among the agriculture-related population: 21.7% of far-

[21] Up to 77% of the enterprises' benefit were ensured by inflationary pressure.

mers and 31.3% of agricultural workers were found to be in poor in 2013, with these two categories accounting for 31% of the country's poor population (World Bank, 2015).

– *Stop the migration process*. The transition to a market economy in agriculture has resulted in a loss of jobs. According to statistical data employment in the agriculture sector counted up to 70% of total taxpayers at the beginning of MTS's transformation. Unfortunately, latter on, there was a strong and stable downward trend in the number of employees in the agricultural sector. The pace of decline in the number of workers in the agricultural sector amounted to 5% annually. Thus, the statics shows a huge decrease up to 50% in 2000, 28% in 2011 and 16% in 2015.

To this end, further improvement in tax collection, by promoting voluntary compliance among taxpayers, and therefore administration are needed[22].

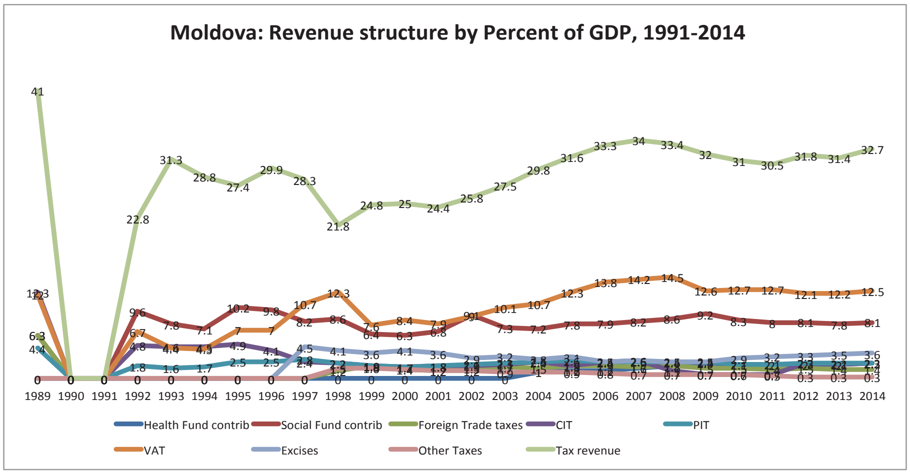

Figure 2. Moldova: revenue structure by percent of GDP, 1991-2014

Source: developed by the author based on different source of the public available data.

Over the past 25 years (1990-2014), the share of tax revenue as a percent of GDP has changed, with volatility from 21.8% to 34.0%, but never reached its pre-1990 level of 41%. The tax revenues are holding the major budget revenues, reaching the highest rate of 85.4% in 2014, including indirect taxes (45.8%) and direct ones (39.7%). While social contributions remained a significant source of revenue, the collection of CIT and customs tax revenues declined substantially (e.g. CIT is reduced from 12.3% in 1989 to 2.2% in 2014 and Foreign Trade taxes – from 6.3 to 1.4, respectively). Introduction of VAT changed the structure of tax revenues, reaching 38.2% of the total in 2014.

[22] It has been recognized that to ensure fiscal discipline and efficient management of public financial resources, the main possibilities for raising revenues should not be through raising taxes, which can reinforce compliance problems, but improving collection and, therefore, administration.

Even though Moldova is an agricultural country its current GDP was not so much influenced by this structure. In 2015, a value of USD 6.188 billion was recorded, which was decline compared to 2014. This result was helped by lower indicators of agriculture, forestry and fishing (-1.7%), with a share of 11.7% in GDP formation.

Agriculture was always one of the least taxed sectors in the economy. Taxes collected from agriculture amounted to 0.8% of GDP in 2013. Moreover fiscal cost of tax expenditure (forgone tax revenue) is over 0.6% of GDP and it has not been negligible (table 8).

Table 8. Tax revenue and expenditure from/to agriculture sector, 2013

Taxes and contributions	Tax expenditure, % of GDP	% of total taxes from agriculture
Reduced CIT rate	0.07	59.0
Reduced VAT rate	0.50	9.7
Reduced Social Security rate (SSCs)	0.05	6.1
Reduced Health contribution rate	0.01	1.2
Total	0.63	63.0

Source: World Bank. 2014. Moldova Public Expenditure review: Agriculture Study.

In Moldova, there are two ways of public spending on agriculture:

– Direct budget spending (in the form of subsidies (current and capital), services (research, education, food safety and extension services) and through donor-supported programmes);
– Tax expenditure (through reduced CIT, VAT, SSCs and health contribution rates).

Table 8 shows that tax expenditure is over 0.6 of GDP, sizable compared to both taxes collected from agriculture and public spending on the sector. Thus, there is 60% of the tax collected in agriculture and about 40% of direct spending on agriculture.

In order to answer our second question: **What do we see?** we can highlight the following features in agriculture area:

– ***Inefficient tax collection***, including excessive expenses and huge administrative burden. Tax expenditures represent around 60% of taxes collected. Informal employment exceeds the formal one (74%).
– ***Law tax morale***:
  – Aggressive attitude of Tax Authority and judges towards taxpayer (finished civil cases in favour of MTA was – 97.2% in 2008 and 85% – in 2013);
  – Uncertainty of tax law (tax law changes – 2-3 times per year);

Subsidies are allocated to a relatively small number of beneficiaries (over 80% of resources are allocated to less than 10% of beneficiaries).

– ***Decreasing support of GDP from agriculture sector***. Taxes in the agricultural sector represent less than 1% of GDP.

Conclusion

Based on our research, it is possible to conclude that tax system does not achieve both financial function[23], contributing to the destabilization of the financial structure (budget deficit, external debt, etc.), and the regulating function (changing tax laws create undue burdens for taxpayers and tax administration, loss of taxpayers' confidence and ultimately their emigration abroad[24]). The tax system, after 20 years, was characterized by oversize, austerity and state's inability to efficiently manage the available resources and some steps were taken in the last 5 years. All changes, slowed down or even harmed the country's development, in particular at local level. Farmers are so constrained that a lot of them decide to abandon this activity. The ability of authorities to implement inefficient laws and their severe administrative burdens are the main reasons for farmers to stop this type of activity.

In order to answer our third question: How to move forward?, the following recommendations were formulated:

Merging the current 35 administrative-territorial units (including local tax offices) into a not more than six or eight modernized facilities. This measure would allow regional offices to operate effectively (small offices are costly) and assure uniformity of the tax law implementation, develop and maintain all recent knowledge, share experience, and specialize in all aspects of the tax administration;

Due to seasonal agriculture activities, there is a need in tax reporting choice to introduce the possibility to choose between: monthly, quarterly, and annual reporting. Larger intervals are less time consuming when compliance burden is critical in seasonal periods. Thus farmers are usually available in the winter to provide tax reporting.

Introducing the possibility of registering entity as VAT payer from zero sales. Thus, small producers that have local processors as customers or any distribution networks will benefit from the same advantages available to medium and large farmers thus stimulating domestic competition.

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[23] The government of Moldova is losing up to 20% of its revenue due to tax collection effort.

[24] According to the 2004 population census, 25% of the labour force works abroad.

Cancellation of restrictions on the acquisition of land by foreigners. Thus, motivating new investors would improve development and competitiveness issues.

Different approach on taxing culture for local farmers vs importers – one of the challenges the country's government is to establish an effective tax mechanism that would ensure transparency, simplicity, tax collection at the same time giving farmers a certain advantage over importers of agricultural products either through less burdensome tax regime or subsidizing part thereof.

Improvement in tax collection, by promoting voluntary compliance among taxpayers, and therefore administration are needed as well. It has been recognized that to ensure fiscal discipline and efficient management of public financial resources, the main possibilities for raising revenues should not be through raising taxes, which can reinforce compliance problems, but improving collection and therefore administration.

Introduction of "personalized" VAT reform. This reform could have significant poverty and shadow economy reduction effect while enhancing neutrality which favours administration.

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