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Kosovo

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Overview of corporate tax work over the last year

The corporate tax practice and the types of corporate tax work carried out in Kosovo during the last year were driven considerably by the country's efforts to harmonise its tax legislation with relevant EU Directives. As an aspiring EU Member State, Kosovo's legal framework is continuously evolving to meet EU standards and best practices. In this respect, Kosovo's tax legislation is also undergoing significant changes to reflect those in the international tax environment, with a particular focus on addressing profit shifting and base erosion.

To this end, last year saw the enactment of important legislation and government measures to supplement the recently introduced Law on Corporate Income Tax that has been in force since September 2015. The most notable changes were the introduction of the Administrative Instruction MoF – No. 02/2017 on Transfer Pricing and the approval of the Government's Fiscal Package 2.0 which consists of a series of measures to improve local business competitiveness.

Although important pieces of tax legislations were introduced in 2017, significant measures that were previously planned for the year were not implemented. The long-anticipated merger of Kosovo Customs and the Tax Administration has not gone through and seems to be postponed indefinitely. Tax breaks and incentives for new businesses that were expected to be implemented via the issuance of a sub-legal act as discussed in last year's edition have not been implemented, whilst the implementation of the aforementioned Fiscal Package 2.0 has been muted due to a change in central government and political events.

Still, the relatively effective implementation of the Stabilization Association Agreement (SAA), which Kosovo signed in 2015, the entry into force of new Double Tax Treaties (DTTs) and the changes that were enacted have overall had a significant positive effect on the corporate tax practice and types of corporate tax work in Kosovo.

Types of corporate tax work

With the highlighted changes in mind, 2017 saw a significant increase in demand for tax advisory services in respect of transfer pricing and the application of Double Tax Treaties. The increase in demand for such services was driven by the firm's dominant position in the Kosovan market and its success in closing deals with major international clients operating in Kosovo. Notably, the majority of clients continue to be subsidiaries or PEs with fixed domicile in Kosovo as well as local companies operating in the domestic market.

The expansion of Kosovo's service sector, which represents the largest sector in the economy, has attracted attention from international firms, resulting thereby in a steady increase in tax due diligence and international tax planning services.[1] In this respect, M&A activity is gradually picking up, but the associated corporate tax work remains low, comparatively speaking.

Notwithstanding the growth in international corporate tax work, corporate tax practice has also seen a growth in demand for domestic services, such as:

- Assistance during tax audits and tax appeals.
- Tax review services.
- General tax advisory services.
- Analysis and feedback to the Kosovan government and tax authorities in respect of legislative and regulative changes circulated for consultation with groups of interest.

Tax review services continued to be in high demand as companies have been taking advantage of the Law on Public Debt Forgiveness, which was applicable until 1 September 2017. In addition, general tax advisory services and assistance in obtaining individual ruling requests from the tax administration have been important services. The gradual implementation of the SAA and the Fiscal Package 2.0 measures have also resulted in increased demand for general tax advisory services.

Key developments affecting corporate tax law and practice

Domestic legislation

The Administrative Instruction on Transfer Pricing (AI) has been published in the context of Kosovo's efforts to follow global trends in tackling base erosion and international tax avoidance. In this regard, the TP instruction was drafted with the framework of the OECD's Transfer Pricing Guidelines in mind, and entered into force on 28 July 2017.

The Administrative Instruction sets out to regulate controlled transactions between related parties from different tax jurisdictions.[2] The Instruction specifies that parties are deemed to be related in case of the existence of a special relationship that may materially influence the economic results of the transactions between them. Additionally, the AI has also stipulated that transactions conducted by a Kosovan taxpayer with persons located in certain jurisdictions designated as tax havens fall within the scope of controlled transactions.

The AI sets out the minimum required elements for fulfilling local documentation requirements. Further, it is stipulated that documentation prepared in accordance with the EU Code of Conduct and its annexes on transfer pricing documentation, and the OECD TP Guidelines (BEPS Action 13), are also deemed to fulfil local requirements. To this end, the required documentation includes both a Master File and a Local File.

As per the AI, transfer pricing documentation must be made available to the tax administration within 30 days upon request and must be submitted in one of the official languages of Kosovo; however, authorities may accept documentation prepared in English. In terms of non-compliance with the above, failure to submit the TP documentation will result in administrative penalties, though the greatest risk pertains to the tax authorities conducting their own analysis.

Taxpayers involved in related party transactions exceeding €300,000 in a given fiscal year are required to submit a notice on their annual controlled transactions along with the annual CIT return and statutory financial statements by 31 March of the subsequent year.

In 2017, the Tax Administration unexpectedly required taxpayers to submit a Notice of Annual Controlled Transactions for the fiscal year 2016 in November, though to our knowledge no transfer pricing audits ensued as a result.

Fiscal Package 2.0

Fiscal Package 2.0 consists of 22 measures designed to ease the process of doing business in Kosovo and to improve the competitiveness of local businesses. With respect to corporate tax work, the relevant measures include the following:

- Temporary tax breaks designed to encourage investments in strategic sectors (agro-processing, tourism and IT) to be implemented via the issuance of an Administrative Instruction.
- Issuance of a sub-legal act regulating conditions under which losses from breakdown, evaporation or loss of weight of oil and its products are recognised, with a possibility of extending weight loss recognition for other products.
- Amendments to the Law on Corporate Income Tax specifically addressing the taxation of insurance companies.

However, it should be noted that the implementation of the above has been stalled due to a change in government and political events in Kosovo. Nonetheless, important measures have been passed, including the following:

- an exemption from customs duties for all products considered to be raw materials for production;
- the issuance of authorisation procedures for local producers that can benefit from exemptions for inputs and machinery used in the production process; and
- the abolition of excise tax on heavy oil for production.

Changes resulting from the application of ECJ cases

The Law on Tax Administration and Procedures foresees that, where questions arise on the correct interpretation of the Law on VAT, the Law shall be interpreted in line with the Sixth Directive and Decisions of the European Court of Justice.[3] Last year marked one of the first applications of the above provision which resulted in the publication of a Public Ruling from the Tax Administration.

The case at hand relates to the insurance industry, where due to frequent changes in VAT legislation that caused confusion among taxpayers, insurance companies did not apply the reverse charge mechanism during the period when insurance and reinsurance transactions were VAT-able. The Tax Administration then instructed insurance companies to apply a reverse charge while not deducting the input VAT for tax periods older than two years due to the time limit for deducting input VAT. The inability to deduct input VAT resulted in potentially high costs for insurance companies.

In response, based on ECJ cases C-95/07 and C-96/07, our firm argued that the time limit on the right to deduct input VAT could not be applied to a person who applied a reverse charge because, by previously not applying the reverse charge, the taxpayer did not harm the budget of the state nor did he profit from any tax advantage. After many discussions and opinions from international experts, it was determined that the Law on VAT should be interpreted according to the aforementioned cases, whereby insurance companies retained the right to deduct input VAT regardless of the time limit. This was also followed up by the issuance of a Public Explanatory Decision from the Tax Authorities.

In addition to being a big victory for the insurance industry, the inclusion of ECJ Decisions set a new standard in tax law enforcement practices in Kosovo, paving the way for future interpretation of Kosovo tax legislation in accordance with EU Directives and ECJ Decisions.

Tax climate in Kosovo

The tax climate in Kosovo remains very favourable and competitive in relation to its Balkan neighbours. As of the time of writing, the World Bank ranks Kosovo very favourably compared to its Balkan peers in terms of both paying taxes and the overall ease of doing business. Kosovo ranks 45th in terms of paying taxes and 40th in terms of overall ease of doing business, with only Macedonia among its neighbours ranking higher in both categories.[4]

Key contributions in terms of this favourable ranking pertain to the convenient electronic filing system that has been gradually extended to enable the electronic filing of most declarations. Congruently, the favourable ranking reflects the declining number of required tax filings/payments as well as the reduced time required to complete tax returns.

Bilateral treaties for avoiding double taxation

Kosovo has concluded, in total, 12 bilateral treaties for avoiding double taxation with the following countries: Albania; Belgium; Croatia; Finland; Germany; Hungary; Macedonia; Slovenia; the Netherlands; Turkey; and the United Arab Emirates (UAE).

It should be noted that four of these treaties were inherited from the Yugoslavian Federation,[5] which makes them non-compliant with all the disputes arising in today's market. In this respect, the government has taken measures to rectify the situation and negotiations with Germany have commenced on a new double tax treaty. Additionally, negotiations with several other states are in place, including with the Republic of Malta, the Republic of Lithuania and the State of Kuwait, amongst others.

Similarly to the provision on the interpretation of the Law on VAT as per the Sixth Directive, domestic tax legislation contains a reference to the OECD Model Convention, whereby the OECD Model Convention is recognised as a source of law only in circumstances where cross-border taxation is not regulated by domestic law, and there are no DTTs in force with the other state.

Developments affecting attractiveness of Kosovo for holding companies

The CIT Law exempts dividends independent of their source, which arguably favours structures such as holding entities, whose structuring may be adapted to their ownership in diverse industries. According to the CIT Law, a Kosovar resident may credit against any income derived from and taxed in a foreign jurisdiction.[6]

It is important to highlight that there is still no CFC or thin capitalisation rules, and the tendency has been for the enforcement of such obstacles to remain at the level of discussion. Moreover, Kosovo has signed only a few DTTs, and though practice and legislation is oriented towards unilateral recognition of the OECD Model Convention, the primary source of law for avoiding double taxation remains to be domestic legislation.

The legal infrastructure is adapted towards favouring non-resident companies establishing themselves in Kosovo. CIT is flat and at a rate of 10% for entities with a revenue of over €50,000 per year. This places Kosovo among the most tax-competitive jurisdictions, though neighbouring jurisdictions share similar rates and conditions, which makes the impact of company migrations still not a distinguishable aspect of the system.

The year ahead

Looking ahead to the next year, significant changes in corporate taxation may be in line. Specifically, the new central government, through working groups created by the Ministry of

Finance, has circulated a Draft Concept Document with proposed changes to tax legislation, touching upon the laws on Tax Administration and Procedures, Value Added Tax, Personal Income Tax and Corporate Income Tax.[7]

The Concept Document has been drafted in the spirit of improving the business environment in Kosovo and clamping down on the informal economy. It should be noted that relevant stakeholders, including our firm, have provided their input to the proposed changes. With respect to corporate income tax, the most important changes include the following:

- Amendment to the provisions on the taxation of insurance companies, whereby insurance companies are taxed on a real income basis. Currently, insurance companies are taxed at 5% of the collection of gross premiums.
- Reduction in the annual turnover threshold for corporations.
- Reduction of the carryforward of losses to four tax years from the current limit of six years.
- Removal of the exemption of dividends, whereby dividends shall be taxable at the ordinary income tax rate.

Further, it is possible that a very important double tax treaty with the Swiss Confederation will enter into force. This DTT is particularly important given the strong economic ties between Switzerland and Kosovo, and the large presence of the Kosovan diaspora in Switzerland.

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Endnotes

1. http://pubdocs.worldbank.org/en/190611492717079013/Kosovo-Snapshot-April-2017.pdf.
2. https://gzk.rks-gov.net/ActDetail.aspx?ActID=14937.
3. Article 86 of the Law on Tax Administration and Procedures No. 03/L-222.
4. http://www.doingbusiness.org/rankings.
5. 8 September 1988, Article 11 states that dividends paid by a company which is resident in the Federal Republic of Germany to a resident of Yugoslavia may be taxed in the Federal Republic of Germany…, while the opposite possibility was not foreseen at all.
6. E.g. withholding tax.
7. http://konsultimet.rks-gov.net/viewConsult.php?ConsultationID=40317.

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Afrore is a Director in the Tax & Legal Department at Deloitte Kosova. She holds a B.A. (Hons) in Accounting and Taxation from London Guildhall University (England), is a member of the Society of Certified Accountants and Auditors in Kosovo (SCAAK) and has completed ACCA and SCAAK qualifications. Prior to joining Deloitte in 2007, Afrore started her career with Simmons Gainsford LLP, a London-based company.

She is a highly recommended tax advisor in the Kosovo market. The main focus of her work is advising foreign investors operating in the market. Her experience includes, but is not limited to, tax advisory services, tax due diligence and tax litigation in a wide range of clients and industries, mostly focusing on the energy, transportation, construction and banking sectors.

She was a member of the Independent Review Board of Appeals from November 2010 to January 2012 and is a member of the British Chamber of Commerce. Currently, she is a member of the AmCham Tax Committee.

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He brings 10 years of experience in the tax field from his previous work in the Kosovo Tax Administration. In the administration, he worked as a tax inspector, a professional standards officer and a VAT adviser. He has also worked with PricewaterhouseCoopers as an assistant manager in the tax and legal department. Ruzhdi is fluent in Albanian and English, and has basic knowledge of German and Serbian.

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