

Kosovo Tax Alert

In this issue:

New Tax Laws Enter Into Force on 1 September 2015

- VAT
- CIT
- PIT



August 2015

A new fiscal package in the form of revised tax laws was passed by the Kosovo Assembly and the relevant legislation is now published in the Official Gazette of the Republic of Kosovo.

The new Law 05/L-037 on VAT includes several significant changes from the previous VAT law (Law 03/L-146 as amended by Law 03/L-197 and Law 04/L-108). Most notably, the standard VAT rate will increase from 16% to 18%, the reduced VAT rate of 8% will apply for certain goods and services and the VAT registration threshold will decrease from EUR 50,000 to EUR 30,000. A sub-legal act on the implementation of the provisions contained in this law will be published by the Minister of Finance within 1 year of its entry into force.

The new Law 05/L-029 on CIT also contains numerous changes to CIT provisions, such as those regulating allowance for bad debts and further clarifies the list of disallowed expenses and deductions for marketing and representation expenses. It also provides for an increased allowance of contributions in the public interest from 5% to 10% (with a possibility of an additional 10% allowance), whereas tax loss carry forwards are reduced from 7 to 6 years and withholding tax at 3% will be applied on certain payments made to non-business persons. As with the previous CIT law, dividends received by resident and non-resident persons continue to remain tax-exempt and certain tax breaks and incentives for new businesses will be introduced in a sub-legal act that will be published latest by 31 December 2015.

Similarly, Law 05/L-028 on PIT includes all of the above changes reflected in Law 05/L-029, and in addition exempts from PIT wages of persons with disabilities, assets received by way of inheritance, income obtained as a result of expropriation or legal compensation, as well as income from grants and donations. Per-diems are now taxable whereas health insurance premiums paid by an employer for an employee are exempt.

VAT

Taxable persons

[Addition] Non-profit organizations are not considered taxable persons for payments deriving from membership, funds, grants or donations received for the purposes of their non-profit activity, except when they receive such payments as a result of an economic activity.

VAT registration

[Amendment] A certificate of import and export is no longer required and only a VAT certificate will be issued for taxable persons.

The VAT registration threshold and turnover calculation method has been changed from EUR 50,000 in the previous 12 months to EUR 30,000 within a calendar year.

[Addition] The law further clarifies that foreign persons conducting an economic activity in Kosovo will be considered taxable persons from the commencement of their activity in Kosovo, and the same applies for the permanent unit of a non-resident person in Kosovo.

Cancellation of VAT registration

[Amendment] Cancellation of VAT registration will be effective 2 months after the request is submitted, provided it is approved by the tax authorities.

Taxable persons cannot cancel their VAT registration at least for 1 more calendar year after the year of registration.

Mixed supply of goods and/or services

[Addition] Supply of services included in the supply or import of goods is considered part of the supply or import of goods, respectively. Similarly, supply of goods included in the supply of services is considered part of the supply of services.

Use of self-supplied services for business needs

[Addition] Construction repair work with respect to immovable property used or to be used for existing or future economic activity and rendered for free by a taxable person or his staff to himself is treated as a supply of services for consideration.

Place of supply of goods

[Addition] For supply of goods on boards of ships, aircraft or trains, in the case of an in-and-out trip, the return leg is treated as a separate transport operation.

Place of supply of services

[Amendment] A point of transport departure shall be the place of supply for passenger transport to a taxable person, and not where the transport takes place proportionate to covered distances.

The same will also apply in determining the place of supply of goods and passenger transport to a non-taxable person.

The place of supply of restaurant and catering services which are physically carried out on board ships, aircraft or trains during the section of a passenger operation within Kosovo is the point of departure of passenger transport operation, not Kosovo.

Chargeability of VAT

[Addition] Long-term contracts shall be regarded as completed:

- In the month of issuance of IPC (Interim Payment Certificate), but not later than 1 month after the issuance of IPC in cases when the technical acceptance of works is made later;
- In cases when one or more IPCs have been issued during the year, at the end of the year it is required for an IPC to be issued based on the real measurement of works completed;
- If no IPC has been issued during the year, then at the end of the year the obligation to charge VAT will arise based on the real measurement of works completed;

Chargeability of VAT for imported goods

[Addition] When imported goods are subject to customs duties, the chargeable event will occur and VAT will become chargeable.

Taxable Amount

[Addition] For supplies made through public auction, the taxable amount is the final value obtained.

For supplies with goods and services not accompanied by an invoice, the taxable amount is deemed the supply to final consumers under the open market value principle.

Rate

[Amendment] Standard VAT rate is increased from 16% to 18%.

[Addition] A reduced VAT rate of 8% will apply to the import and supply of the following goods and/or services:

- Supply with water, except bottled water;
- Supply with electricity, including transmission and distribution services, with central heating, waste collection and other waste treatment;
- Grains such as barley, corn, maize varieties, oats, rye, rice and wheat;
- Products made from grain for human consumption, such as flour, pasta, bread and similar products;
- Cooking oils made from grains or oilseeds for use in cooking for human consumption;
- Dairy and dairy products intended for human consumption;
- Salt appropriate for human consumption;
- Eggs for consumption;
- Textbooks and serial publications;
- Supply including lending of books from libraries including brochures, leaflets and similar printed materials, children's picture books, drawing and coloring books, music printed texts or manuscripts, maps and hydro graphic charts and similar;
- Information technology equipment

- Supply with medicines, pharmaceutical products, instruments, medical and surgical devices;
- Medical equipment, ambulances, aids and other medical devices to facilitate or treat inability for exclusive use by the disabled, including the repair of such goods and supply with children's vehicle seats;

Exemptions without right of deduction for certain activities in the public interest

[Amendment] Supply of medicines, pharmaceutical products and medical and surgical instruments and apparatus will no longer be exempt from VAT, but subject to the reduced VAT rate of 8%.

All activities carried out by public radio and television bodies will be exempt from VAT. The previous VAT law specified that only those not of a commercial nature are VAT exempt.

[Addition] Supply of public transport services to travelers and their baggage, with prices set by the competent state authority will be VAT exempt.

Exemptions without right of deduction for other activities

[Amendment] Transactions of life and health insurance and reinsurance, including related services performed by insurance brokers and insurance agents will be exempt from VAT. The previous VAT law did not limit the type of insurance transactions that are VAT exempt.

Supply of houses, apartments or other accommodation used for residential purposes, including garages and basements is VAT exempt. The previous VAT law did not include garages and basements in the definition of VAT exempt supplies of accommodation.

[Addition] International road transport of passengers by bus and other vehicles and transport of accompanying goods, such as suitcases or supply of services related to passenger transport, from one place in the territory of Kosovo to a place outside of it and vice-versa, will be VAT exempt.

Exemptions on importation

[Amendment] Import of catches of fishing vessels and fishing boats used for the purpose of carrying out a fishing activity into a port, subject to certain conditions, will no longer be VAT exempt.

In line with their supply no longer being VAT exempt, import of medicines, pharmaceutical products, medical and surgical instruments and apparatus will no longer be VAT exempt.

[Addition] Import of the following goods will be VAT exempt:

- Production lines and machinery for use in the production process
- Raw materials used in the production process
- Information technology equipment
- Newspapers and periodic publications
- Equipment and materials for the needs of electronic and written media

Transitional period

[Amendment] The transitional period for VAT exemption on imports and supplies of goods and/or services funded from proceeds of donations made to or through the Kosovo budget or under the supervision of competent bodies or directly financed through contracts for the benefit of public authorities from international organizations and their agencies, governments, government agencies, governmental or non-governmental organizations in support of humanitarian and reconstruction programs and other projects, including European integration projects in Kosovo, has been removed and such imports and/or supplies will remain VAT exempt unless the new VAT law is amended.

Exemptions related to certain transactions treated as exports

[Addition] The supply of goods and services to foreign staff of special diplomatic and consular missions accredited in Kosovo, including their family members will be VAT exempt.

The supply of goods and public services to Kosovo Religious Communities in accordance

with the respective legislation on religious freedom and other applicable legislation will be VAT exempt.

The supply of goods and services co-financed by proceeds of donations from foreign governments and the Kosovo budget for public benefit project, if the exemption is provided by agreement between the parties and the co-payment from the Kosovo budget is not more than 20%, will be exempt from VAT.

The right to deduct VAT

[Amendment] The new law clarifies that a taxable person cannot deduct input VAT on representation costs, which include only costs for hosting and entertainment during business or social contacts, including food, drinks and accommodation costs. A taxable person, however, can deduct input VAT on marketing expenses, meals and transportation for personnel.

The previous VAT law did not make such a distinction but only provides an exception when representation costs are incurred for personnel in charge of making supplies of goods and/or services.

Exercise of the right of deduction

[Addition] A taxable person who pays VAT compensation is entitled to deduct the VAT compensation as deductible, provided that he has paid the VAT compensation and the value of goods and services received to the farmers, and that the goods and services were intended for taxable supplies for which the right for the deduction of input VAT is established.

Manner to exercise the right of deduction

[Amendment] The taxable person will no longer be required to notify in advance the Head of the Regional Tax Office for late deductions of input VAT.

Calculation of the deductible proportion of input VAT

[Amendment] In absence of data on transactions in the preceding year, or where they were insignificant in amount, the provisional

deductible proportion shall be determined by the taxable person, on the basis of the taxable person's own forecasts, regarding which the taxable person should notify TAK. The previous VAT law required that tax authorities determine the provisional deductible proportion.

VAT refund claims

[Amendment] A taxable person may claim a VAT refund if they maintain a credit position for 3 consecutive months and the amount of VAT credit exceeds EUR 3,000 and all VAT and other tax returns for past tax periods have been submitted. The previous VAT law allowed the taxable person to submit a refund claim only in the last tax period of a calendar quarter and if the VAT credit amount exceeds EUR 5,000.

A taxable person that has exports may claim a VAT refund after each tax period, provided only that the amount of VAT credit exceeds EUR 3,000. The previous VAT law required that export transactions represent at least 25% of all transactions by the taxable persons and that the amount of VAT credit exceeds EUR 5,000.

Deduction of input VAT on commencement of economic activity

[amendment] On the day the registration for VAT purposes becomes valid, a taxable person acquires the right to a deduction of input VAT for goods in stock from the moment the VAT threshold is reached. The previous VAT law allowed for the right of deduction of input VAT on goods in stock the day before the VAT registration becomes valid.

Bad debt for VAT purposes

[Amendment] Where the whole or part of payment for a taxable supply is not received by a supplier and is considered as uncollectable by initiating court procedures, the respective VAT deduction is allowed.

This VAT deduction is allowed in each tax period after the debt becomes bad and starts at least 6 months after closing the tax period for which VAT has been in applied in respect of that supply. The taxable person must issue a 'bad debt' invoice for the uncollected amount and in

cases when such bad debt is subsequently paid, a 'bad debt paid' invoice must be issued.

[Addition] No initiation of court proceedings is required for bad debt up to 500 EUR.

Uncollected amounts are not considered bad debt if:

- Transactions with the same debtor have been recurring after recognizing bad debt (exception for public services to be provided in a sub-legal act);
- Bad debt is between related parties; or
- There is insufficient evidence that substantial efforts have been made to collect the debt, including each applicable action to optimize the debt collection.

The previous VAT law did not foresee the EUR 500 threshold under which no initiation of court proceedings is required, and required the taxable person to apply to the tax authorities for the recognition of bad debt.

Requirement for books and records

[Amendment] When IT programs are used to store accounting and tax records, it is no longer required that the agreement between the taxable person and the outsourcing specialist be provided to the tax authorities, and they will no longer be jointly and severally liable for the payment of tax.

Retention of books and records

[Addition] Documentation on immovable property must be kept for a minimum of 20 years.

CIT

Definitions

[Amendment] Market value is defined as the complete amount to be paid by the consumer at the same market rate in which the supply of goods and services occurs, under the conditions of equal competition, for the supplier under the prevailing market within Kosovo where the supply occurred, in order to obtain goods and services in question at the moment. When a comparison cannot be found, the market value can mean a) for goods, an amount not lower than purchasing price of goods or similar goods or cost at time of supply; b) for services, an amount not lower than the complete cost of the taxable person providing the service.

The previous CIT law did not provide for the method of determining market value when comparisons cannot be found.

Natural persons are also further defined as non-business natural persons (without a registered business activity) and business natural persons (with a registered business activity).

The definition of financial leasing no longer includes the conditions which determine a finance lease, such as a) if the lease exceeds 75% of the life of the asset; b) if there is a transfer of ownership at the end of the lease term; c) if there is an option to purchase the asset at the end of the lease term and d) if the discounted present value of lease payments exceeds 90% of the fair market value of the asset.

Exempt income

[Addition] Income exempt from CIT now includes income earned from grants, subsidies and donations, in compliance with relevant regulations and conditions.

Disallowed expenses

[Amendment] Tax losses from transactions between related persons cannot be deducted, except when the transaction is in compliance

with the market value. The previous CIT law strictly disallowed the recognition of losses from related-party transactions.

[Addition] Disallowed expenses now also include:

- Expenses for presents, other than those with the name and logo of the business, which are part of representation expenses
- Losses in specific weight or substance, damages, remains, surplus, destructions or demolitions during production, transport and storage, beyond the norms set forth in a sub-legal act.
- Benefits in nature in the form of meals and transport tickets, unless organized by the business
- Rent expenses for apartments serving as accommodation and lodging for resident and non-resident employees, irrespective of contract or employment terms.
- Expenses covered by grants, subsidies and donations, in compliance with relevant regulations and conditions

Allowable expenses

[Amendment] Training expenses inside and outside Kosovo paid by an employer for an employee related to his or her work will be allowable without limitations in the year in which such training expenses occur. The previous CIT law limited training expenses to an amount of EUR 1,000 per tax period per employee.

Allowable deductions for activities in the public interest

[Amendment] Contributions in the form of donations or sponsorship for humanitarian, health, education, religious scientific, cultural, environmental protection and sports are allowed as a deduction up to a maximum of 10% of taxable income computed before such contributions are deducted. In addition to this deduction, taxpayers that contribute to certain areas as prescribed by special laws can have an additional allowance of 10%.

The previous CIT law only provided for a deduction of charitable contributions at a maximum rate of 5% of taxable income before this deduction.

Costs for representation, advertising and promotion

[Amendment] Representation costs include costs that a business person incurs in organizing meetings, presentations, inaugurations and similar and are limited to 1% of annual gross income. Advertising and promotion costs however are fully deductible for tax purposes.

The previous CIT law limited representation expenses to only 50% of amounts invoiced and not exceeding 2% of gross annual income.

Bad debt expenses

[Amendment] Bad debt expenses are allowable if the below conditions are fulfilled:

- Payment has not been received in whole or in part and declared uncollectable by initiating court procedures;
- The debt is at least 6 months overdue
- Amount that corresponds to debt has previously been included in income
- There is no dispute on the legal validity of the debt
- There is sufficient evidence that substantial attempts were made to collect such debt

Taxpayers must issue 'bad debt' invoices and for bad debts in amounts up to EUR 500, no initiation of legal procedures is required.

Deductions for bad debt are made only for the amount uncollected. In case of collection, the amount received must be included in income of the tax period of collection.

Uncollected amounts are not considered bad debt if:

- Transactions with the same debtor have been recurring after recognizing bad debt, except for public services
- Bad debt is between related parties;
- There is insufficient evidence that substantial efforts have been made to

collect the debt, applicable action to optimize the debt collection.

- The debt is 24 months or more overdue

In the case of banks, foreign bank branches and non-banking financial entities, write-off of bad debt is recognized as deductible if the following conditions are met:

- 365 days following the submission of the request to commence proceedings with the executor, in cases where loans have been secured with personal or real estate
- 365 days following the issuance of a court order for execution, in cases where loans have not been secured with personal or real estate

The previous CIT law did not foresee the EUR 500 threshold under which no initiation of court proceedings is required, as well as the 24 months statute of limitations and the recognition of bad debt for financial institutions.

Payments to related persons

[Amendment] Compensation or emoluments, interest, rent and other expenses paid to a related person are allowed as an expense in an amount equal to the market value.

The previous CIT law recognized expenses made as a result of related -party transactions in an amount equal to the minimum actual payment or the open market value.

Depreciation

[Amendment] Assets with a purchase price up to EUR 1,000 are allowed as a current expense, except when such assets function as part of one entirety and the value of such entirety is over EUR 1,000.

The previous CIT law did not provide the above exception when such assets function as part of an entirety.

Special allowance for new assets

[Amendment] The special allowance of 10% for the purchase of new assets or assets put into use in Kosovo for the first time is no longer

constrained by economic activity previously limited from 2010 to 2012.

Amortization

[Addition] In cases when the useful life of an intangible asset is not determined, amortization expenses are allowed up to 20 years.

Tax losses

[Amendment] Tax loss carry forwards are decreased from 7 to 6 years.

Withholding tax on emoluments, pensions, interest, royalties and rents, lottery wins and gambling

[Amendment] Every employer is responsible of withholding tax from taxable salaries paid to his/her employees, including payments to non-business natural persons, for professional, technical, management, and financial services, payments for service contracts, actors' plays, musicians, athletes, agents etc.

In the previous CIT legislation, withholding tax on payments to non-business natural persons was not foreseen.

[Addition] Pensions paid from, or in the interest of Kosovo Pension Savings Fund or other fund as well as health insurance according to the Law on Health Insurance, will be subject to withholding tax by the payer of such pensions or health insurance in the rates foreseen by the applicable PIT legislation.

Withholding tax for special categories

[Addition] Each taxpayer making payments to non-business natural persons, farmers, agriculturists, collectors of recycled materials, fruits, plants and similar, is obliged to withhold tax at 3% of the gross payment made at the time of payment.

Withholding tax on certain payments for non-residents

[Amendment] Income earned by contracts or agreements, both written and oral, with persons or entities in Kosovo by a non-resident person or entity from services carried out in Kosovo is

subject to withholding tax by the payer of the income at a rate of 5%, as long as the non-resident person or entity has no permanent establishment in Kosovo.

The previous CIT law required the application of such withholding tax only on payments to non-residents exceeding EUR 5,000 in any tax period.

Tax payments

[Addition] If taxpayers with annual gross income up to EUR 50,000 do not earn any income in a given quarter, no payment is required but the taxpayer will still be required to submit the quarterly instalment declaration.

[Amendment] Taxpayers will not be subject to any penalties or interest for quarterly payments of corporate income tax if the difference between the amount due in each instalment and the amount paid for each instalment is not greater than 20% of the actual amount due, or if after the taxpayer's first tax period, the amount paid in each instalment is at least 10% higher than 1/4th of the tax liability of the preceding tax period.

For taxpayers in their first tax period as a business, no penalties or interest will apply if the amount of quarterly advance payments, including the 4th quarter, is above 80% of the final tax liability for that period.

The previous CIT law provided for a difference of only 10% and quarterly advance payments above 90% of the final tax liability, respectively.

PIT

In addition to the above changes to the CIT law, most of which are also applicable for PIT, the below are additional changes made to PIT provisions in the new PIT law:

Definitions

[Addition] The definition of Employer is further expanded to include diplomatic, consular and liaison offices of foreign states in Kosovo when they agree to take on the responsibilities of an employer in Kosovo; and religious communities as foreseen by Law on Freedom of Religion in Kosovo.

Gross income

[Amendment] Gross income includes capital gains resulting from sale of a capital asset, including movable and immovable property and securities.

The previous PIT law instead foresaw capital gains resulting from an increase or a decrease in the value of shares.

Exempt income

[Addition] Income exempt from PIT further includes:

- Wages of persons with disabilities as foreseen under relevant laws
- Assets received by way of inheritance if a) heir is a spouse, biological or adopted child or parent of the deceased; or b) heir is a person other than the abovementioned and the inheritance value does not exceed EUR 5,000
- Training expenses incurred by an employer for an employee related to his or her job
- Income received, including that in cash or in kind, by a non-business natural persons as a result of expropriation by the state
- Mandatory contributions paid by the employer for health insurance for the

employee, as defined by the relevant legislation on health insurance

- Compensation benefits received from final court decisions and court costs compensation
- Income in the form of remuneration from state institutions for achievements in science, sports and culture
- Income received as a result of financial compensation to former political prisoners and other similar compensations
- Income received from grants, subsidies and donations in accordance with the terms and conditions

[Amendment] Expenses above EUR 1,000 per employee per tax period will no longer be considered as taxable income for the employee.

Income from wages

[Amendment] Per-diems will also be treated as taxable income from wages, in addition to bonuses, commissions and other forms of compensation an employer or someone on his or her behalf pays to employees beyond their salary.

Benefits given to foreign employees to facilitate their living in Kosovo, such as housing and school tuition, will no longer be tax exempt.

Withholding tax on interest, royalties and rent

[Addition] Each business natural person, partnership or grouping of persons paying rent must withhold 9% of tax on gross income at the time of payment or crediting.

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