New Draft Law on Income Tax
Summary of changes

28 August 2015

By the end of July, the Ministry of Finance has circulated amongst the groups of interest the Draft Law on Income Tax, inviting for comments and suggestions until the end of August 2015. This Draft Law covers all types of income taxes: Personal Income Tax (PIT), Corporate Income Tax (CIT) and Withholding Tax (WHT). This Draft Law is expected to be part of the 2016 Fiscal Package and enter into force as of 1 January 2016.

The Tax and Legal Department of Deloitte Albania has prepared a technical analysis of the main changes presented by the Draft Law compared to the Current Law "On income tax" no. 8438, dated 28.12.1998, as amended. It is worth pointing out that this merely a draft and subject to discussions and further approvals. As such, we suggest that taxpayers provide their comments, suggestions, and concerns to such groups of interest (i.e., Chambers, Tax Advisors, etc.) including Deloitte professionals in order to bring them to the attention of the decision makers. The following summary does not contain any comments or opinions of Deloitte Albania in relation to these changes.

Overview of the main changes brought by the Draft Law

Definitions

- The Draft Law updates and/or introduces new terms and definitions such as 'taxpayer', 'business', 'turnover', 'incorporation', 'transfer of a branch/branches of activity', 'exchange of shares', 'merger', 'division', etc.

• Corporate Income Tax

Permanent Establishment

- The Draft Law introduces a time limitation of '6 months' as regards the existence of a Permanent Establishment (PE) in Albania of a non-resident company. According to it, a non-resident company will be deemed to create a PE in Albania if:
  a) It conducts in Albania activities related to a building site, a construction, assembly or installation project, or supervisory related to them, if such site, project and activities last more than 6 months;
  b) It renders services, other than those related to item a) above, including consultancy services, through its employees or other personnel engaged for such purpose, if such activities continue within the territory of Albania for periods aggregating more than 6 months within any 12-month period.
- *The Current Law "On income tax" no. 8438, dated 28.12.1998, as amended (following referred as "Current Law") does not provide any time limitation for PE purposes.*

Taxpayers subject to CIT

- The Draft Law determines as subject to CIT:
  a) Any person other than a physical person;
  b) Any entity carrying out or being capable of carrying out business activity in Albania or generating income from sources in Albania, including unlimited partnerships, limited partnerships, limited liability companies, joint stock companies, joint ventures and any other association or cooperation of persons;
  c) Any foreign entity, association or cooperation of persons similar in nature to one of the forms mentioned above, that is established according to foreign law.
- *The Current Law determines as subject to CIT juridical persons, partnerships and any other forms of establishment, provided that such persons are subject to VAT in Albania (excluding persons subject to simplified profit tax on small business).*

Exempt income

- The Draft Law designates as exempt from CIT income from dividends and distribution of profits if:

a) The recipient holds at least 10% of the shares or voting rights of the distributing entity, and
b) This minimum shareholding/participation has been held for an uninterrupted period of at least 24 months.

There is an option to exempt income from distributions which do not meet one of these two conditions, by providing a guarantee to the Tax Administration for the amount of tax otherwise due, until the date the minimum shareholding has been held for 24 consecutive months.

- *The Current Law exempts income from dividends and profit distributions if the distributing entity is a taxpayer of CIT in Albania, regardless of the percentage of shareholding that the beneficiary has in that entity and the period of time that such shareholding is held.*

Thin capitalization rules

- According to the Draft Law, interest expenses are disallowed as deductible expenses if the net interest expense (i.e. after deducting any interest income) exceeds 30% of taxable earnings before interest and taxes (i.e. of the adjusted EBIT) as determined based on the financial statements.
- *The Current Law determines as non-deductible the interest expenses on the portion of the loan in excess of 4-times the net equity.*

Impairment losses/technical provisions for financial institutions

- According to the Draft Law, a deduction will be allowed for amounts to establish/increase and/or decrease:
  a) Mandatory technical reserves created pursuant to Law no. 8081, date 7.3.1996 “For insurance and reinsurance activities”; and
  b) Mandatory provisions for commercial banks and other financial institutions created according to supervisory rules issued by the Bank of Albania for this purpose.
- *Based on the Current Law, impairment losses/technical provisions of banks are recognized if calculated in accordance with International Accounting and Financial Reporting Standards (IAS/IFRS) and certified with no disclaimer by external authorized auditors. Whereas, there is currently no provisions as regards 'other financial institutions'.*

Valuation of share exchange

- The Draft Law provides the possibility to choose between 2 alternatives of special rules for the valuation of the shares received in connection with an incorporation or a transfer of a branch/branches of activity. One of the alternatives is to choose on measuring them either at market value, or at the original acquisition price of the transferred shares (upon a joint request addressed by the entities to the Tax Administration).
- *There are no such provisions under the Current Law.*

Transfer Pricing

- The Draft Law includes more extensive provisions related to Transfer Pricing compared to the Current Law. However, these additional provisions are similar to the provisions currently included under Instruction no. 16, dated 18.6.2014 "On Transfer Pricing" and Instruction no. 9, dated 27.2.2015 "On Advance Pricing Agreements".

Provisions against tax avoidance

- The Draft Law contains certain provisions against tax avoidance which allow the Tax Administration to disregard an arrangement (transaction, agreement, event, etc.) in assessing the taxable profit of a taxpayer, if that arrangement lacks economic substance and is put in place for the main purpose of obtaining a tax benefit.
- *There are no such provisions under the Current Law.*

Long term contracts

- The Draft Law defines as 'long-term contracts' those concluded for the purpose of manufacturing, installation or construction or the performance of services, expected to last more than 12 months. It allows revenues relating to long-term contracts to be recognized for CIT purposes based on the percentage of completion, determined:
  a) Either by reference to the ratio 'actual costs/overall estimated costs', or
  b) By reference to an expert evaluation of the stage of completion at the end of the year.
- *There are no specific provisions for long-term contracts under the Current Law.*

Taxation of capital gains on the transfer of business assets and liabilities

- One of the alternatives provided by the Draft Law is that capital gains realized on the transfer of business assets and liabilities in connection with an incorporation, transfer of a branch of activity, a merger or division, may be not taxed immediately, but deferred until the sale of these assets and liabilities by the receiving company. This tax deferral is conditional upon a list of criteria.
- *There is no such option under the Current Law.*

Non-deductible expenses

- The Draft Law adds/changes to the list of non-deductible expenses as provided by the Current Law the following items:
  - Depreciation expenses according to accounting rules;
  - Expenses incurred as personal consumption of shareholders, partners, persons executing power in management of the taxpayer and their families;
  - Expenses for technical services, consultancy and management invoiced by non-resident if not paid by the taxpayer within the tax period (in case such expenses are paid later, they are tax deductible in the tax period when they are paid);
  - Expenses linked to income not included in taxable profit;
  - Bribes.

Depreciation

- The Draft Law provides that a full year's depreciation is allowed in the year of acquisition or entry into use of an asset (whichever comes later), whereas no depreciation is deducted in the year of its disposal.
- *Under the Current Law, an asset is depreciated starting from the 1st of the month following its entry, and until the end of the month of its disposal.*
- The Draft Law provides the following methods and rates of depreciation allowed for CIT purposes:

Category of assets	Depreciation basis	Rate of annual depreciation
Buildings, installations and constructions that serve for more than 15 years	Historic cost of the individual asset	3%
Intangible assets	Historic cost of the individual asset	15%
Computers, information systems, software products and equipment of database back up	Opening book value 'for tax purposes' for the category as a whole (pooling system), after adding purchase costs of new assets and subtracting selling price of disposed assets	25%
All other assets	Opening book value 'for tax purposes' for the category as a whole (pooling system), after adding purchase costs of new assets and subtracting selling price of disposed assets	20%

- *Under the Current Law, the first category includes fixed assets intended for use of more than 20 years (instead of 15 years) and the respective rate of annual depreciation is 5% on net book value (instead of 3% on historic cost).*
  For the third and fourth categories, the Current Law does not specify the depreciation basis as being book value 'for tax purposes'.

Bad debt deductions

- The Draft Law provides an escalation for the recognition of bad debts as deductible expenses provided that the taxpayer has taken reasonable steps to pursue payment from the unrelated party:

% of recognition of bad debt	Period of time the bad debt is due as at year-end
20%	6 months
40%	12 months
60%	24 months
85%	36 months

- *The Current Law does not provide any such options.*

Tax losses

- According to the Draft Law tax losses can be carried forward and utilized against tax profits in the next 5 years, according to the principle "earliest losses utilized first".
- *Based on the Current Law, the carry-forward period is 3 years and their utilization follows the same principle.*
- The Draft Law specifies that tax losses expire in case of a change of direct or indirect ownership of shares or voting rights of the company with more than 25% in value or number.
- *Under the Current Law, this rule applies for changes of more than 50%.*
- The Draft Law provides a new special right to carry-over losses of the transferor company to the receiving company in case of incorporation, transfer of a branch of activity, a merger or a division.

Advance CIT payments

- Based on the Draft Law, CIT advances are due by the 20th of each month and are calculated as 1/12 of the prior year CIT liability (if it was higher than 30 kALL i.e. 215 EUR).
- *Under the Current Law advance payments are made on a quarterly basis, but monthly instalments are allowed as well. The monthly instalments of the first 3 months are equal to 1/12 of the CIT of two previous years. The instalments of the next 9 months are equal to 1/12 of the CIT of the previous year.*

  - **Withholding Tax**

Withholding tax agent

- According to the Draft Law, any corporate income taxpayer and any personal income taxpayer receiving business income, will serve as 'withholding tax agent'. Withholding tax will be paid on the 20th of the month following the earliest of:
  a) The date when income was actually paid;
  b) The date when the withholding tax agent accounted for the underlying liability.
  In case of dividends, regardless of when they are actually paid out, withholding tax must be paid by the end of the 3rd month following after the month of decision taken by the statutory body of the company.
- *Under the Current Law, withholding tax is paid within the 20th of the month following the date of payment of the underlying liability; whereas for dividends, within 20th of August of the year following the year subject to decision for distribution.*

Income subject to withholding tax

- The Draft Law subjects to withholding tax certain types of income paid to resident taxpayers regardless of their status i.e. regardless of the fact that such taxpayers are already subject to CIT (*unlike the Current Law*). We have summarized the new rules in the following table:

Types of income	Subject to WHT if paid to resident taxpayers	Subject to WHT if paid to non-resident taxpayers
Dividends and profit distributions	Yes	Yes
Interest	Yes	Yes
Royalties and copyright income	Yes	Yes
Rents for property that is not part of business assets	Yes	Yes
Incomes of individuals from the games of chance and casino	Yes	Yes
Payments for technical, management, and consultancy services	No	Yes
Insurance premiums	No	Yes
Fees for management and participation in directing councils	No	Yes
Payments for constructions, installment, assembling or related supervising work	No	Yes
Payments for performance of actors, musicians, or sportsmen, etc.	No	Yes

- A taxpayer subject to CIT deducts from the annual CIT payable (in its annual CIT declaration) the withholding taxes paid on its behalf by other taxpayers during the year.
- *There is no such rule under the Current Law.*

• Personal Income Tax

Residence

- According to the Draft Law, an individual will be deemed to be resident in Albania for tax purposes in a certain tax year if he/she is present in Albania for a period exceeding '182 days in any 12-month period ending in the tax year concerned'.
- *Under the Current Law, an individual will be deemed to be resident in Albania for tax purposes if he/she is present in Albania for a period exceeding '183 days in the tax years concerned'.*

Taxable income

- The Draft Law indicates as personal taxable income the employment income, business income, investment income and other income, regardless of whether they are paid in cash or in kind. According to it, income in kind are measured at market value.
- *The Current Law does not provide any specification regarding the taxation and measurement of income in kind.*

Employment income

- The Draft Law contains a full and long article regarding employment income only. It provides what types of remunerations will be considered as 'employment income', depending on their payer (employer or other persons), their form (in cash or in kind) and the moment of their earning. There is a clearer definition of the 'employer' and a new provision related to 'employment income paid to the employee through a workforce agent not resident in Albania'. The usage of company car for private purposes (regardless of for how many days during the month) is considered as benefit in kind and is calculated at 1% of the costs of that car for each month of usage.

There is a clearer list of income that are not taxable employment income such as:

a) Meals, work equipment, medical treatment and other benefits provided in employer's premises and available equally to all employees;
b) Reimbursement of travel and accommodation expenses, as well as travel allowances;
c) Contributions for life and other than mandatory health care insurance made by the employer up to 5% of the gross employment income of the employee, etc.

Business income and expenses

- The Draft Law provides the list of income that will be considered as 'business income' for the individual, including:
  a) Income from business of any kind;
  b) Income from independent activities; as well as
  c) Income from copyrights, patents, trademarks, industrial, commercial or scientific equipment or know-how, etc.

  When the taxpayer's annual turnover does not exceed 8 million ALL (57,100 EUR), he/she is allowed to deduct lump-sum expenses from his/her business income (instead of claiming documented expenses) in the amount of (a) 40% in case of production business activities, and (b) 15% in other cases.

Investment income

- The Draft Law defines as 'investment income' income from dividends, interest, alienation of shares and participations (not part of business assets), alienation of property (not part of business assets), etc. It also determines certain types of income which will not be taxable investment income.

Personal income tax base

- According to the Draft Law, the personal income tax base is determined as a sum of annual taxable employment, business, investment and other income, decreased by allowances and deductions.
- Resident personal income taxpayers will be allowed to deduct from the tax base:
  a) A personal allowance of 180 kALL (1,280 EUR),
  b) An allowance for dependent child of 48 kALL (340 EUR),
  c) Education of dependent children and medication, up to a certain limit, only for resident taxpayers with annual taxable income less than 2 million ALL (14,280 EUR).

An alternative to the simplified profit tax for small businesses

- The Draft Law proposes an alternative to the simplified profit tax for small businesses (*if the current one of 7.5% on taxable income, but not less than 250 kALL/year, will be abolished*), whereby:
  a) To a taxpayer with business income turnover more than 2 million ALL (14,280 EUR) and less than 8 million ALL (57,100 EUR), is allowed a 30% decrease of annual taxable business income;
  b) To a taxpayer with business income turnover less than 2 million ALL, is allowed a 50% decrease of annual taxable business income.

Personal income tax rate

- The Draft Law determines a personal income tax rate of 15% applicable only to investment income, whereas for all other types of income, it proposes the following tax base and rates:

Annual tax base (ALL)	Tax rate
0 – 180,000 (1,280 EUR)	5%
180,001 – 1,560,000 (11,140 EUR)	13%
1,560,001 – more	23%

  Note: Based on the comments of the consultants of IMF who have assisted in the preparation of this Draft (left in the English version of the Draft), the amounts and rates indicated are only illustrative and do not reflect any decision taken by the government to change the personal income tax rates.
- Personal income tax on employment income will be withheld on a monthly basis by the employer and paid to the Tax Administration within the 20th of next month. The employer with which the individual has signed a Statement on Personal Status (before the first payment received by that employer) will calculate tax based on the progressive table above. All other employers during the same month (if there are more than one), will calculate employment income tax at the rate of 15%. The first employer deducts on a monthly basis 1/12 of the personal allowance of 180,000 ALL (1,280 EUR) before calculating employment tax for the individual.

- *Under the Current Law, all personal income except employment income are taxed at 15%. Employment income are taxed by reference to a monthly tax base (instead of an annual) at the following progressive rates:*

Monthly tax base (ALL)	*Tax rate*
0 – 30,000 (214 EUR)	*0%*
30,001 – 130,000 (930 EUR)	*13%*
130,001 – more	*23%*

Annual personal declaration of income

- The Draft Law requires personal income taxpayers to submit an annual personal tax declaration when during the year they earned more than:
  a) 1,5 million ALL (10,710 EUR) of employment income, and
  b) 50 kALL (350 EUR) of other than employment income not subject to withholding tax.
- *Under the Current Law, this obligation lies with individuals earning more than 2 million ALL (14,280 EUR) of income (including all types).*

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