



# Corporate Tax

Fourth Edition

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# Albania

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## Overview of corporate tax work over last year

### Types of corporate tax work

Albania was awarded candidate status by the EU in June 2014 and is now in the process of implementing reforms with a view to membership, under the assistance of EU as part of the Instrument for Pre-accession Assistance (IPA II) for the period 2014–2020.

In this context, Albania has undertaken and already partially implemented significant tax changes in the last one to two years, by replacing existing laws and introducing new ones aligned to EU legislation and best practice.

A new Law on VAT is effective as of 1 January 2015, which has been significantly harmonised with the corresponding EU Directive 2006/112/EC and has brought significant changes to the main VAT principles and rules in Albania.

A new Customs Code has been conceived and structured in line with the Union Customs Code (UCC), which was adopted as Regulation (EU) no. 952/2013 of the European Parliament and of the Council. This new Customs Code, published in 2014, is gradually replacing the existing one with the intention of a complete replacement by 1 June 2017.

With the assistance of the International Finance Corporation, an elaborated Transfer Pricing regulation has been drafted in accordance with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (2010), and has been published in 2014 by introducing Transfer Pricing documentation and reporting requirements for 2014 and onwards. The Transfer Pricing regulation was subsequently extended in 2015 with a detailed instruction on Advance Pricing Agreements.

A new draft Law on Income Tax (covering corporate income tax, personal income tax and withholding tax) has been drafted by making reference to EU countries' legislation and best practice and has been circulated for comments amongst groups of interest during 2015 (please see below). It is expected to become final and enter into force by 1 January 2017.

During 2015, as a first phase under a general programme of actions against fiscal informality, the Albanian government introduced in the Law on Tax Procedures a number of significant measures (please see below). As a second phase of actions, the role of the fiscal administration is being restructured during 2016 through a new strategy, focusing on simplifying tax procedures and compliance and increasing efficiency in tax collection.

As regards the corporate income tax, Albania applies a progressive scheme, which has slightly changed under the 2016 Fiscal Package:

- Taxpayers with annual turnover from ALL 0–5m (approximately €35,000), are exempt from corporate income tax. Previously the threshold was up to ALL 2m (approximately €15,000).

- Taxpayers with annual turnover from ALL 5–8m (approximately €35,000–57,000), are subject to a simplified corporate income tax at the rate of 5%. Previously the rate was 7.5% and applied to the segment ALL 2–8m.
- Taxpayers with annual turnover higher than ALL 8m (approximately €57,000) are subject to a flat corporate income tax rate of 15% (it was 10% up to 31 December 2013).

The taxable profits and losses are calculated by adjusting for tax purposes the accounting result according to the financial statements (prepared based on the applicable accounting standards). The concept of consolidated tax base applies, i.e. operative losses/profits are combined and offset with capital gains/losses.

In the context of all the significant changes, the last year showed an increase of our:

- advisory work to businesses for the implementation of the new Law on VAT and measures against fiscal informality;
- assistance with the understanding and application of Transfer Pricing regulation and reporting requirements; and
- analysis and feedback to the Albanian government on draft laws circulated for consultation with groups of interest, with a special focus on the draft Law on Income Tax.

### Significant deals and themes

#### M&A

The last one to two years have seen the following major M&A transactions or announced transactions:

- Through Law no. 114/2014, the Albanian government took over all the shares of the operator of electricity distribution CEZ Shperndarje sh.a. formerly under the ownership of the Czech company CEZ, a.s.
- Crédit Agricole S.A. announced in May 2015<sup>1</sup> the signing of an agreement to sell Crédit Agricole Albania (a second level bank) to the Albanian company Tranzit Sh.p.k., a subsidiary of NCH Capital Inc. Completion of the transaction is subject to clearance from the relevant regulatory authorities and according to applicable legal and social regulations.
- Bankers Petroleum Ltd. announced in March 2016<sup>2</sup> that it has entered into a definitive agreement for the purchase of all the issued and outstanding common shares with affiliates of Geo-Jade Petroleum Corporation, one of the largest independent oil and gas exploration and production companies in China. Completion of the Arrangement is subject to customary closing conditions, including receipt of court, shareholder and regulatory approvals.
- Petromanas Energy Inc. announced in March 2016<sup>3</sup> the closing of the previously announced sale of substantially all of the assets of Petromanas Albania GmbH, Petromanas' wholly owned subsidiary, to Shell Upstream Albania B.V., a wholly owned subsidiary of Royal Dutch Shell plc.

Besides the above, several other similar transactions of a smaller scale have taken place in the last two years, involving Albanian companies, subsidiaries of foreign companies, their branches, etc. Without entering into the details of specific transactions on corporate income tax situations of the Albanian companies, subsidiaries or branches involved, we would like to present here two hot topics related to M&A: the carry forward of tax losses; and the taxation of capital gains.

#### Carry forward of tax losses

As a general rule, Albanian taxpayers are entitled to carry forward tax losses resulting in a certain year and utilise them against taxable profits of the three subsequent years based on the

rule “earlier losses utilised first”. If during a year, there is a change in direct and/or indirect ownership of subscribed capital or voting rights by more than 50% in number or value, the tax losses of that particular year and of previous years expire. This restriction is based on the view that tax losses are exclusively related to the taxpayer bearing them, therefore reference is made to the owner of the taxpayer.

The application of this restriction becomes particularly controversial for these two categories of M&A transactions:

- A change of ownership in shareholders structure of an ultimate parent publicly listed in a stock exchange market outside of Albania, resulting in an indirect change of ownership of more than 50% for the Albanian affiliate. The Albanian legislation on corporate income tax is silent on whether and how the free trade of shares of the ultimate parent dispersed among the general public (which are not necessarily reported) should affect the carry forward of tax losses of the Albanian affiliate.
- A merger or takeover between Albanian affiliates of the same owner(s), whereby the newly established or the absorbing entity has the same owner(s) as before the transaction. In principle, all rights and obligations are transferred to the new entity/absorbing entity. The Albanian legislation on corporate income tax is silent on whether and how the tax losses of the merged or absorbed affiliates can be transferred to the newly established or the absorbing entity (by respecting the three-year and utilisation limitations) in the circumstances where, in fact, there is no change in effective ownership.

#### Taxation of capital gains

The Albanian legislation on corporate income tax is silent as regards the taxation in Albania of capital gains deriving from sale of shares in Albanian entities.

When a double tax treaty is in place between Albania and the country of residence of the shareholder (please see below), the provisions of the treaty will prevail over the Albanian legislation. As such, if the treaty provides for the exemption of such gains from tax in Albania, this provision will prevail. However, double tax treaties are not automatically applied in Albania. The General Tax Directorate has the sole authority to approve the application of treaty provisions for all specific circumstances of taxpayers after the latter follow certain application procedures to benefit from exemptions, reduced rates and credits. In this case, it is unclear whether the obligation to follow said procedures for obtaining approval of exemption from capital gains tax in Albania lies with the non-resident shareholder, or such exemption applies automatically. In practice, in a few cases, Albanian tax authorities have charged the Albanian entities whose shares were traded, with withholding tax liabilities on behalf of the non-resident shareholders.

The situation is even more unclear for capital gains of shareholders resident in countries with which there is no double tax treaty in place.

#### Tax procedures in case of M&A

Pursuant to Law no. 9901/2008 On Entrepreneurs and Commercial Companies, as amended, a company registered with the commercial register for more than one year may be restructured by merger or division. Dissolving companies resulting from such mergers or divisions are deregistered from the commercial register and do not undergo the liquidation process. In principle, all rights and liabilities are transferred to the remaining company/new company(ies). Pursuant to some amendments in the legislation on Tax Procedures in December 2014, the commercial register has a legal obligation to notify the tax administration, immediately when the relevant taxpayer(s) initiate the procedures for merger/division as above. In

such cases, despite the fact that the commercial legislation provides for tax liabilities to be transferred to the remaining/new company(ies), the tax administration is entitled to follow the same procedures as for a regular liquidation. This includes the right to perform a tax audit (when it is considered necessary) to the dissolving companies, which should therefore pay all tax liabilities prior to their deregistration.

### Transfer pricing

The new transfer pricing regulation introduced in 2014 requires an Albanian taxpayer engaged in controlled transactions with non-resident associated parties to ensure consistency of the controlled transactions with the ‘market principle’. ‘Associated parties’ means entities that have a direct or indirect participation in the management, control or capital of one another or by the same third party. To determine the consistency of controlled transactions with the market principle, the regulation recommends the nine-step process of comparability analysis given by the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (2010) and the application of the five approved transfer pricing methods (other methods may be applied where none of these five can reasonably be applied).

Thanks to the initiative of the big four consultancy firms to increase awareness on transfer pricing regulation and risks, a significant number of medium and large taxpayer members of multinational groups took the necessary measures to prepare the transfer pricing documentation for the years 2014 and 2015 up-front. According to the regulation, taxpayers are required to make such documentation available to the tax administration within 30 days following a request.

Furthermore, taxpayers engaging in controlled transactions exceeding in aggregate ALL 50m within a year (approximately €357,000), are required to complete and submit by the 31<sup>st</sup> March of the following year an ‘Annual Controlled Transactions Notice’. The first submissions of this kind were made by 31<sup>st</sup> March 2015.

Immediately after, the tax administration commenced sending requests for submission of transfer pricing documentation and conducted a number of first transfer pricing audits assisted by external consultants from the Italian tax administration. The preparation and submission of the documentation on time (within 30 days after the request) did not prevent the tax administration from making a transfer pricing adjustment (if necessary), but avoided the application of penalties on the additional corporate income tax liabilities assessed (only interest for late payment applied).

It is yet to be tested in practice how any transfer pricing adjustments made by a transfer pricing audit will affect the concerned transactions for other tax purposes, e.g. VAT, customs duties, withholding taxes, etc.

### Advance pricing agreement

Starting from March 2015, any taxpayer whose cross-border-controlled transactions in a period of five years are expected to exceed in total the value of €30m, is entitled to apply for an advance pricing agreement (APA). In case the threshold is not expected to be met, the request may still be accepted if the case is sufficiently complex or it is highly important in commercial and economic terms for Albania. If there are double tax treaties in place with the countries of the other associated parties, applications should be bilateral or multilateral APAs. Unilateral filings for APAs will be taken into consideration by the GTD only on special occasions (e.g. when the foreign tax administration does not agree to enter into negotiations). The administrative fees payable by the taxpayer

comprise ALL 50,000 (approximately €360) upon filing of application and ALL 1.2m (approximately €8,500) for bilateral and multilateral or ALL 300,000 (approximately €2,000) for unilateral APAs.

The maximum time period covered by an APA is five years. The tax authorities may audit a taxpayer that has entered into an APA as part of their regular tax audits; however, for the transactions covered by the APA, the purpose of the audit shall be limited to compliance with the provisions of the APA (which has determined in advance the transfer pricing methodology).

To the best of our knowledge, there is not yet been any APAs concluded in Albania and there is only one in the negotiation stage.

#### Permanent establishment

Under the current Law on Income Tax (in force since 1998), Permanent Establishment (PE) is defined as a fixed location of business where an entity carries out its business activity. Specifically, the following are considered as PEs: an administration office; a branch; a factory; a workshop; a mine, an oil or gas well or a quarry; any other place of extraction of natural resources; and a construction or installation site. The said law provides for no minimum time period for any of the above to be considered as a PE. If there is a double tax treaty in place, the related provisions for the determination of a PE, including any time limitations, will prevail.

We have noted some controversy between interpretations of Albanian tax advisors on the consequences of creating a PE in Albania as a result of managerial, professional, consultancy and other types of services provided herein.

One interpretation is that the non-resident person has the obligation to register the PE with the Albanian tax authorities in the form of a branch (there is no option to formally register a PE as such). The registered branch would pay tax on income attributable to it in the form of corporate income tax, by deducting costs (including those recharged by the Head Office). However, the registered branch would also trigger all other applicable taxes, e.g. VAT, social and health contributions and employment income tax (for the employees), local taxes, etc., as well as other compliance obligations e.g. preparation and audit of statutory financial statements.

Another interpretation is that the non-resident person has no obligation to register the PE in the form of the branch. Such decision remains at the discretion of the non-resident person and should not be necessarily driven by tax reasons. The Albanian beneficiary of the services in such case would have the obligation to retain 15% withholding tax from the gross payment made to the non-resident and remit it to the Albanian tax administration. However, the PE would not be allowed to deduct any costs in determining the amount subject to Albanian income tax. On the other hand, the PE would not typically be subject to other taxes and compliance obligations.

#### Withholding tax on services

We have noted an increasing controversy between taxpayers and tax advisors on one hand, and Albanian tax authorities on the other, as regards the application of withholding tax on managerial, professional, consultancy and other types of services provided with no physical presence of personnel/equipment in Albania when no double tax treaty is in place.

The general understanding of taxpayers and tax advisors is that such services should not be taxable in Albania (and therefore the Albanian beneficiary should not be charged with withholding tax liabilities) because they do not create a PE in Albania according to the definition of the law.

The interpretation of the Albanian tax administration is that such services should be subject to withholding tax in Albania, to be retained by the Albanian beneficiary, as long as the source of payment for such services is in Albania, regardless of where they are carried out.

### Thin capitalisation rule

Interest expenses pertaining to the part of loans exceeding four times the net equity, are not deductible for corporate income tax purposes. Unlike in many other countries where the thin capitalisation rule applies to loans by shareholders having more than a certain percentage of shares (e.g. 25%), in Albania such rule applies to all loans, except for short-term loans (payable within less than one year). The rule does not apply to banks, finance leases or insurance companies.

There is particular controversy in application of this rule on branches of foreign companies, which by default, have no subscribed capital and therefore no way of increasing net equity except for retained profits.

### Administrative tax appeal and court procedures

The tax administration conducts a risk assessment analysis to select taxpayers for a tax audit or inspection. It examines the accuracy of all documents that relate to legal status, residence status, economic activity, payments and tax liabilities, and any other documents relevant to determining tax liability.

Against a tax assessment, the taxpayers may file an appeal to the Tax Appeal Directorate (a higher ranking administrative directorate within the General Tax Directorate of Albania) within 30 calendar days after the taxpayer has received or is deemed to have received the assessment notification. In order to file an appeal, a taxpayer should pay the full amount of the tax liability, excluding penalties. In December 2013, an option was introduced to create a bank guarantee for such amount, instead of the payment.

The term for the Tax Appeal Directorate to issue a decision on an appeal was reduced from 90 days to 60 days. Following the administrative appeal procedure is an obligatory precondition to follow court procedures. Against the decision of the Tax Appeal Directorate, the taxpayer may file a lawsuit to the relevant administrative court. Administrative courts have been functional since late 2013 and the time needed for review of administrative cases is been significantly shorter compared to civil courts.

We emphasise that in case the administrative appeal of the taxpayer is successful, the regional tax directorate that issued the assessment has the right, as does the taxpayer, to appeal in court the decision of the Tax Appeal Directorate.

Taking into account that in practice, tax directorates file a court petition against almost all decisions in favour of taxpayers, the latter face the awkward situation where they are forced to undergo court proceedings despite the positive decision of the Tax Appeal Directorate. The Appeal Court of Tirana filed a petition with the Constitutional Court of Albania requesting the abrogation of such right of the regional tax directorates. However, the Constitutional Court rejected the request through a final decision by considering such right as not in contradiction to the Albanian Constitution.

## **Key developments affecting corporate tax law and practice**

### Domestic – cases and legislation

#### *Measures against fiscal informality*

In September 2015, the Albanian parliament approved some amendments to the law on Tax



Procedures aimed to strengthen the legal provisions against tax informality and included a number of high penalties.

The very positive development which occurred while implementing such measures was that they were widely discussed in the business environment, which considered most of them as inappropriate. Against such law, the Association for the Protection of Entrepreneurs and the Market filed a petition with the Constitutional Court of Albania challenging the constitutionality of such amendments. The Constitutional Court, firstly with an interim decision, decided on the suspension of the law and thereafter through a decision of March 2016 decided the partial acceptance of the request by abrogating a number of the articles of such law, which mainly related to high penalties.

The most significant measures left in force were:

- Extending the definition of fiscal evasion to include the following infringements and providing the tax administration with the right to charge the taxpayer with criminal offence in case of the recurrent non-declaration of employees: maintenance, utilisation and transportation of goods by non-registered persons; non-installation of the electronic cash register; or non-issuance of fiscal coupons.
- Subjecting the corporate income tax prepayment instalments to a 15% penalty in case of failure to pay within the monthly/quarterly deadlines.
- Restricting direct sales to end-customers by wholesalers.
- Introducing the concept of ‘tax certification’, i.e. certification of ‘financial statements and tax declarations’ as ‘in compliance with the fiscal legislation’ by an authorised audit company engaged for this purpose. The benefit of this certification, however, has been limited to improving the taxpayer’s position in the risk assessment performed by the tax administration when selecting taxpayers for tax audit.

### Double tax treaties

Albania has entered into double tax treaties with 41 countries, out of which 37 are effective (Poland, Romania, Malaysia, Hungary, Turkey, Czech Republic, Russia, Macedonia, Croatia, Italy, Bulgaria, Sweden, Norway, Greece, Malta, Switzerland, Moldova, Belgium, China, France, Egypt, Netherlands, Kosovo, Serbia & Montenegro, Austria, Latvia, South Korea, Bosnia & Herzegovina, Slovenia, Spain, Ireland, Germany, Singapore, Qatar, United Kingdom, Kuwait and United Arab Emirates), and four are not yet effective (Luxembourg, Estonia India and Iceland). They are principally based on the OECD Model Convention and they have certain differing provisions compared to each other based on the year in which they were respectively signed.

In the recent year, Albania entered into a new double tax treaty with Kosovo (substituting a former one entered with UNMIK) and Iceland.

A withholding tax return has been introduced in December 2014 (there was no such declaration applicable before) and the obligation to prepare and submit it on a monthly basis applies to all taxpayers.

### Inspired by international developments

#### *Anti-avoidance measures*

The Albanian tax legislation provides local tax authorities with the right to re-characterise or disregard transactions in case of lack of substantial economic reasons and effects. With the introduction of the detailed transfer pricing regulation in 2014, this provision of the income tax legislation was improved. In this context, there is now increased scrutiny over transactions involving ‘tax havens’. Transactions between an Albanian resident person or a non-resident

person having a PE in Albania and a person resident in a jurisdiction out of the 65 listed in the transfer pricing regulation, is deemed ‘controlled transactions’ and is subject to transfer pricing requirements, regardless of the relationship between the parties. This list of 65 jurisdictions includes Panama, Monaco, San Marino, British Virgin Islands, Jersey, Guernsey, Liechtenstein, Marshall Islands, Monaco, U.S. Virgin Islands, Philippine, Hong Kong, etc.

#### *Exchange of tax information*

Albania adhered to the Convention on Mutual Administrative Assistance in Tax Matters since 2013. Pursuant to this Convention, the Albanian tax administration has the right to receive information not only from banks and non-bank financial institutions but also from each individual who possesses the information concerned.

In March 2016, Albania approved the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information and assigned the Ministry of Finance and the General Tax Directorate as the appointed competent authority for Albania. The intended first information exchange for Albania is in September 2018.

#### *FATCA*

Twenty-one Albanian financial institutions (mostly second level banks, subsidiaries of foreign financial institutions) are currently listed as with approved FATCA registration.<sup>4</sup> These financial institutions have therefore committed to reporting about financial accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest.

### **Tax climate in Albania**

Based on the most recent World Bank report on Doing Business,<sup>5</sup> Albania stands at 142 in the ranking of 189 economies on the ease of paying taxes.

The tax climate over the last year has been reflective of the Albanian government’s measures against fiscal informality, initiatives to increase efficiency in tax collection and simplify procedures of tax reimbursement, implementation of a new e-tax filing system for the declaration and payment of taxes as well as for the electronic communication between taxpayers and the tax administration.

The focus is now on implementing a risk assessment platform that will classify taxpayers according to their risk level and will be followed by an increase in electronic communication and a reduction of tax audits at taxpayers’ premises.

Although appreciated, these changes were rapid and intensive, and therefore debated by the business and media.

### **Developments affecting attractiveness of Albania for holding companies**

Albania generally does not provide for specific tax incentives or attractions for holding companies.

The following may, however, be of interest in case of a holding company established in Albania:

- For inbound dividends distributed to the Albanian holding company by its subsidiaries:
  - In case of domestic subsidiaries, dividend income is exempt from corporate income tax.
  - In case of foreign subsidiaries, dividend income is subject to corporate income tax but credit of foreign tax paid is available (up to 15%) if there is a double

tax treaty in place with the country of the foreign subsidiary. In this regard, a certain administrative inconvenience is caused by the current format of the corporate income tax return, which does not provide for such credit option.

- For outbound dividends distributed by the Albanian holding company to its shareholders:
  - In case of resident shareholder entities subject to Albanian corporate income tax, no withholding tax liability is applicable.
  - In case of resident shareholder individuals, withholding tax of 15% is applicable.
  - For foreign shareholders, withholding tax of 15% is applicable. However, if such shareholders are resident in countries with a double tax treaty in place, the withholding tax rate may be reduced or even zero-ed depending on the respective treaty provisions.
- Please see above in relation to possible income tax on the future sale of shares of the Albanian holding company by its shareholders.

### **Industry sector focus**

#### Banking

The provisions for impairment losses on loans have been subject to large disputes between the majority of banks in Albania and the tax administration. Banks apply IAS/IFRS for statutory financial reporting purposes. On the other hand, banks apply a special manual of accounting for regulatory reporting to the Central Bank of Albania (BoA). Up to 2010, the Law on Income Tax recognised as deductible for corporate income tax provisions for impairment losses calculated in accordance with BoA rules. Since 2011 and up to 2013, a change in the Law determined that provisions for impairment losses as assessed in the IAS/IFRS audited statutory financial statements would be deductible, but in any case without exceeding the amounts determined based on BoA rules for the same purpose. This rule was unclear and caused confusion amongst banks and tax authorities. Since 2014, the limitation of deductibility up to BoA's amounts/rules has been removed and the rule is now clear and acceptable by both parties.

#### Oil and gas

Hydrocarbons contractors entered into Production Sharing Agreements with the Albanian government benefit from a special corporate income tax regime. They are taxed at 50% of the taxable profit calculated after recovery of all hydrocarbons recoverable costs (capital and operational), as provided by the respective Agreements. Services from subcontractors and imports of materials at the exploration phase may benefit from VAT exemption if approved by the National Agency of Natural Resources by relieving hydrocarbon operators from an excessive cash burden at the exploration phase.

#### Strategic investors and operators of economic development zones

In May 2015, the Albanian Parliament passed Law no. 55/2015 On Strategic Investments in the Republic of Albania. This legal instrument aims for the encouragement and attraction of domestic and foreign strategic investments in the economic sector through the establishment of specific favourable administrative procedures that facilitate and accelerate the services and support to the investors.

Some noteworthy tax incentives and reliefs were introduced in September 2015 for operators and developers of technology and economic development zones such as the special VAT treatment of goods entering the economic zones, the exemption from corporate income tax

for a certain time period, deductibility of various expenses for the purposes of corporate income tax, etc.

### The year ahead

Apart from the measures to combat fiscal informality and those to increase the efficiency of the tax administration, the major change expected is related to the new Law on Income Tax. Based on the draft law circulated for comment amongst groups of interest in August 2015, the following major changes to corporate income tax may be expected, amongst others:

- New rules for PE determination, including a time limitation.
- New rules for exemption of dividend income from corporate income tax related to a minimum shareholding and for a minimum period of time.
- New thin capitalisation rule limiting the net interest expenses to a percentage of taxable earning before profit and tax.
- Special rules for the valuation of the shares received in connection with an incorporation or a transfer of a branch/branches of activity.
- Special tax avoidance rules allowing the tax administration to disregard transactions lacking economic substance put in place for the main purpose of obtaining a tax benefit.
- Recognition of revenue on long-term contracts based on the percentage of completion.
- Taxation of capital gains on the transfer of business assets and liabilities.
- Changes in the depreciation methods allowed for tax purposes and introduction of the concept book value 'for tax purposes'.
- Extension of period for utilisation of tax losses.
- Subjecting certain payments to withholding tax although paid to resident taxpayers.

The new Law is expected to be finalised and enter into force on 1 January 2017.

\* \* \*

### Endnotes

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