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Kosovo

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Overview of corporate tax work over last year

As of July 2015, the Assembly of Kosovo has approved a new fiscal package in the form of new tax laws on Value Added Tax (VAT), Personal Income Tax and Corporate Income Tax (CIT). The new fiscal package became effective in September 2015, with most significant changes noted in the new VAT law and some certain changes in the CIT law, too. Following the implementation of the new fiscal package, throughout 2016 the tax administration of Kosovo has issued several administrative instructions (i.e. No. 06/2016) and public rulings in establishing procedures and guidance on the proper interpretation of certain tax articles, such as the application of the reverse charge mechanism in the area of construction, treatment of donations, etc.

Additionally, with the purpose of increasing the collection rate of public liabilities, a new law on public debt amnesty was introduced, which became effective in September 2015 and will be in force until 1st September 2017. It is also worth mentioning that there is still a significant increase in demand for tax review services, due to the incentive for taxpayers to utilise the right of amnesty of certain unpaid liabilities towards the tax administration if certain conditions are met, and part of the liabilities are duly paid.

The majority of clients continue to be subsidiaries or PEs with a fixed domicile in Kosovo, as well as local companies operating within the domestic market. Very few local companies are parent companies with ownership or control over foreign capital, hence international tax planning services are not as much in demand as tax review services.

Nevertheless, the firm anticipates that changes in the preceding year will be essential in both legislative and corporate tax work, mostly due to the expected introduction of the Administrative Instruction on Transfer Pricing in late 2017 or early 2018.

A draft version has already been published. Accordingly, documentation requirements are as per OECD Transfer Pricing Guidelines on OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (2010), and documentation prepared as per "EU Resolution 2006/c176/01 on the code of conduct on TP Documentation" is considered to fulfil local legislation requirements.

Additionally, an administrative instruction on implementation procedures for double taxation agreements is expected to be published this year as well. Currently there are no procedures in place, and a request for an individual ruling from the Tax Administration is required prior to implementing any of the provisions of a double taxation agreement.

Finally, it is worth mentioning that in 2015, the Republic of Kosovo signed the Association and Stabilisation Agreement with the European Union and the implementation of the agreement is already taking place quite effectively. Currently there are reduced customs rates applicable for all goods that are considered of EU origin. Kosovo will also be aiming to enhance the exchange of information with EU Member States to facilitate the enforcement of measures preventing tax fraud, evasion and avoidance. Accordingly, Kosovo shall also complete the network of bilateral agreements with EU Member States along the lines of the latest update of the OECD Model.[1]

Types of corporate tax work

Tax review and services for tax compliance with the domestic tax legislation have been the main services provided for the firm's clients. The firm's services are in fact the most demanded tax services in the local market. Nevertheless, as noted above, an increased sensitivity from taxpayers concerning implementing provisions of double taxation agreements and compliance with the foreseen documentation requirements for transfer pricing purposes is notable.

Additionally, the firm has assisted numerous clients in restructuring processes and assisting in utilising the most tax-efficient option. Most notably, in the last couple of years the firm has assisted the unbundling process of the formerly state-owned Electricity Distribution Operator from the Public Electricity Supply Operator. The unbundling process in this case has been a statutory requirement due to the transposition of EU energy legislation into the local framework.

A number of additional restructuring works have been performed by the firm, again mostly by assisting the demerger of an existing corporation into two distinct entities. For utilising the most tax-efficient reorganisation option, an approval from the Tax Administration of the reorganisation plan is required.

There were no landmark cases in cross-border transactions that were treated by a more complex scheme. The general lack of more complex restructurings and cross-border transaction schemes is certainly not due to a restrictive local tax regime. On the contrary, the Kosovar taxation environment is transparent and dynamic in complying with the European Union and international practices in both direct and indirect taxation.

Key developments affecting corporate tax law and practice

As already stated earlier in this chapter, a new fiscal package was introduced on 1st September 2015, which was ratified by the Kosovo Assembly. The new CIT Law provides a number of changes from the previous one. The main changes in the new CIT Law affecting tax treatment are summarised as below and there have been no changes in 2017 to these provisions:

- A safe harbour for bad debts of a value lower than €500. For such bad debts, no initiation of legal procedures is required.
- Income exempt from CIT now includes income earned from grants, subsidies and donations, in compliance with relevant regulations and conditions.
- Tax loss carry forwards are reduced from seven to six years.
- Tax losses from transactions between related persons cannot be deducted, except when the transaction complies with the market value. The previous CIT law strictly disallowed the recognition of losses from related-party transactions.
- 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 €1,000 per tax period per employee.

- Contributions in the form of donations are allowed as a deduction up to a maximum of 10% of taxable income calculated 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.
- The difference in expenses and deductions for marketing and representation expenses has also been elaborated upon further. The treatment of these expenses has often been the subject of dispute between the Tax Administration and taxpayers.
- A special allowance of 10% for the purchase of new or existing assets has been put into use in Kosovo for the first time.
- In attempts to combat the informal economy, a withholding tax of 3% will be applied on certain payments made to non-business persons.

Additionally, it is worth mentioning that the new Law on VAT, which includes several significant changes from the previous one, affected the type of tax work performed by the firm more significantly than CIT Law. Most notably, the standard VAT rate increased from 16% to 18%, certain goods and services are now subject to a reduced VAT rate of 8% and the VAT registration threshold has decreased from €50,000 to €30,000. Administrative Instruction 3/2015 on implementing the provisions of the new VAT Law became effective on 1st September, 2015 and several public rulings were issued throughout 2016 in order to better clarify the interpretation of certain articles (i.e. reverse charge in construction area, donations, etc.).

Compared to the previous Administrative Instruction 10/2010, the current one provides a comprehensive interpretation of the respective provisions of the VAT Law. VAT application procedures are elaborated in more detail, and therefore the VAT treatment of transactions that have been subject to dispute between taxpayers and the Tax Administration of Kosovo have now been resolved. Additionally, the new Administrative Instruction provides a list of goods subject to the reduced VAT rate of 8%.

It is worth mentioning that, although not directly affecting corporate tax, the increase in the standard VAT rate has nonetheless increased costs for taxpayers dealing with VAT-exempt supplies without the right of crediting input VAT. This has mostly affected the financial and construction sector.

The construction sector has been particularly affected by the new fiscal package, since the new Administrative Instruction has also foreseen reverse charge procedures to be applied to all service providers within the construction area and the Public Explanatory Decision 05/2016 has further clarified its application following several areas of confusion on its interpretation by the taxpayers. Similar to the standard reverse charge mechanism, the obligation to pay VAT is transferred to the taxable person registered for VAT in Kosovo, to whom the supplies are delivered. The term supplies shall include construction services or construction services and materials supplied. If the supplies are only construction materials, the transaction is not subject to the reverse charge mechanism.

Domestic – cases and legislation

Although the main activities performed by the firm include tax compliance, tax review and *ad hoc* tax advisory services, the firm has observed a moderate increase in uncommon tax work.

For legislative context, it should be noted that, although the general rule provides that losses may not be carried forward if there is an ownership change of over 50%, despite the change in ownership, the Tax Administration may allow losses to be carried forward in certain approved restructurings through M&A, demerger, insolvency, and exchange of shares. A number of companies have utilised this right in the last couple of years.

The firm has observed a moderate increase in restructurings through demerger procedures, especially in relation to the division of real estate from actual business activities. This is due to the real estate industry being one of the most profitable sectors in recent years.

Restructuring assistance has also been performed in conjunction with progressivity in taxation, in some cases effected from the neighbouring jurisdictions,[2] which posed uncertainty in regards to the *neutrality principle*.

As mentioned earlier in this chapter, the firm has assisted in the unbundling process of the formerly state-owned Electricity Distribution Operator from the Public Electricity Supply Operator. The unbundling process in this case has been a statutory requirement due to the transposition of EU energy legislation into the local framework.

Cross-border considerations

Transfer pricing

Kosovar tax legislation law denotes the *OECD MC* as a source of supplementary law. Consequently, Kosovo also indirectly recognises its derivative documents, including the OECD Transfer Pricing Guidelines on Multinational Enterprises and Tax Administration (2010), and thus BEPS as well.

With the introduction of the Draft Administrative Instructions on transfer pricing, which is expected to enter in force during 2016, many of the multinational enterprises (MNEs) present in Kosovo have already started being attentive in complying with the foreseen transfer pricing documentation requirements.

If the draft passes as such, a taxpayer involved in potentially controlled transactions exceeding €50,000 within a fiscal year is required to notify the Tax Administration. The Tax Administration may scrutinise such transactions in harmony with the transfer pricing guidelines. The tax administration may demand the taxpayer to provide documentation for transfer pricing purposes within 30 days from the date of the request.

In fact, the draft specifically refers to its compliance with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (2010) and states that documentation prepared as per the "EU Resolution 2006/c176/01 on the code of conduct on TP Documentation" is considered to fulfil local legislation requirements.

Energy

The current energy legislation in Kosovo is in the process of transposing the requirements of Package III of the EU legislation for energy. Most notably, it is worth mentioning that the draft law on electrical energy includes an anti-discriminatory clause for cross-border wholesale energy trading.

In this respect, the draft law, in line with the EU Secretariat of the Energy Community, has inferred a provision where licences issued for wholesale electric energy trading within the Energy Community shall be recognised in Kosovo. Hence, suppliers licensed in another contracting state will have the right to trade electric energy without the need for a local licence.

As per current law, wholesale electricity trading companies are required to be established in Kosovo in order to obtain a wholesale trading licence. Should the draft law enter into force, such wholesale electricity trading companies will not be required to have any corporate presence in Kosovo.

Tax climate in Kosovo

Bilateral treaties for avoiding double taxation

Kosovo has concluded, in total, 10 bilateral treaties for avoiding double taxation with the following countries: Albania; Belgium; Finland; Germany; Hungary; Macedonia; Slovenia; the Netherlands; and Turkey.

Four of these are inherited from the Yugoslavian Federation[3] which makes them non-compliant with all the disputes arising in today's market. Nevertheless, an important double tax treaty with Turkey became effective on 1st January, 2016, which will mean more cross-border corporate tax work in harmony with the treaty due to the capital that Turkish resident entities own in Kosovo.

According to the provisions[4] on interest, dividends and royalties, such income may be taxed in either jurisdiction; this leaves room for discretion to the respective Tax Administration. Additionally, this DTT's protocol foresees that a PE in the event of construction works will be established after a period of 12 months. The establishment of PE regarding construction works is prolonged for an additional six months if another BIT is concluded within the same period of time (18 months) with another state. These two scenarios are already provided for, while in the first scenario the outcome is established on a case-by-case basis. The outcome of the second scenario remains to be seen once Kosovo has signed new DTTs.

On the other hand, as stated above, domestic tax legislation has a reference to the OECD Model Convention, whereby the OECD Model Convention is recognised as a source of law only in circumstances when 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 such structures as holding entities, whose structuring may be adapted to the 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.[5]

It is important to highlight that there are still no CFC or Thin Capitalisation Rules, and the tendency to enforce such obstacles have remained at the discussion level. Moreover, Kosovo has signed only a few double tax treaties, 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 in 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 its impact on company migrations still not a distinguished aspect of the system.

The year ahead

Kosovo continues to enhance its tax competitiveness by maintaining a 10% flat corporate income tax rate. Dividends received by resident and non-resident persons will continue to be exempt.

A noteworthy change will occur with the introduction of the Administrative Instruction on transfer pricing (TP), which is expected to require companies to prepare transfer pricing documentation. The transaction threshold to be scrutinised by the Tax Administration in harmony with TP rules is quite low – for transactions exceeding €50,000 – and it is predicted that the volume of services required for TP and the market in general will be vast, which will make experience in the sector scarce.

Developments in cross-border taxation will intensify, as Kosovo is expected to conclude other DTTs, and the possibility of reconsidering tax liabilities and the taxation nexus, in conformity with such DTTs, will broaden.

<u>Other</u>

Certain tax breaks and incentives for new businesses are expected to be introduced in a sub-legal act (AU-00/2016) which is already obtainable in draft format. This draft allows businesses investing a certain amount and hiring a certain number of employees to benefit from two to six years of tax breaks regarding CIT. To benefit from such tax breaks, an entity must:

- invest over €10m within three years with at least 120 hired employees for a six-year tax break;
- invest over €5m within three years with at least 80 hired employees for a four-year tax break;
- invest over €2m within two years with at least 50 hired employees for a three-year tax break; or
- invest over €500,000 within three years with at least 30 hired employees for a one-year tax break.

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Endnotes

1. Association and Stabilisation Agreement between the European Union and Republic of Kosovo.
2. Albania, a neighbouring jurisdiction, imposes progressivity in excise tax based on the production capacity of the supplier.
3. 8th September, 1988, Article 11 states that dividends paid by a company which is a resident of 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.
4. In Article 11.
5. E.g. withholding tax.

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