



Tax Legislation Update

July 2017

In July 2017, the government of Kosovo introduced significant changes to the local tax landscape, reflecting Kosovo's progress towards consistency with international tax practices and an attempt for integrating the local fiscal system into the global tax framework.

The recent measures address the long-standing need for tax transparency, in addition to the need for improving the investment climate and making the business environment more attractive. Thus, we expect the changes to have an overall positive effect.

This newsletter provides an overview of the following:

- Administrative Instruction MoF-No.02/2017 on Transfer Pricing;
- Fiscal Package 2.0.

We hope you find the newsletter helpful and informative.

Feel free to contact us should you need to discuss in more details on how these changes may affect your business.

1. Transfer Pricing

The Administrative Instruction MoF-No.02/2017 on Transfer Pricing (“TP Instruction”) sets out the procedures for the administration and application of related party transactions

Introduction

The TP Instruction has been published in the context of Kosovo’s efforts to follow global trends in tackling international tax avoidance. Thus, the TP Instruction has been drafted in line with OECD’s Transfer Pricing Guidelines.

The TP Instruction entered into force in July 28, 2017 and is applicable for Kosovo CIT taxpayers involved in transactions with related parties, subject to different jurisdictions. The requirements foreseen in the TP Instruction will mostly affect Kosovo taxpayers, which are part of an international company.

The TP Instruction follows OECD’s *arm’s length* principle. This principle dictates that transaction with a related party must be entered into under comparable conditions and circumstances as a transaction with an independent party.

Related Party

The TP Instruction provides that parties are deemed related, in case of a special relationship that may materially influence the economic results of the transactions between them. Related party relationships include the following:

- One person holds or controls 50% or more of the shares or voting rights in the other person’s company;
- One person directly or indirectly controls the other person;
- Both persons are directly or indirectly controlled by a third person;
- Persons are relatives of the first, second and third degree.

***Note that the TP instruction is not applicable for related party transactions within Kosovo.**

Controlled Transactions

The term controlled transactions and related party transactions are used interchangeably throughout the update.

A controlled transaction for TP purposes means a deal, understanding, agreement or practice between related parties. Additionally, controlled transactions include transactions of a Kosovo taxpayer with a person located in certain jurisdictions considered by the TP Instruction to be tax havens.

Controlled transactions include transactions of goods, services, intangible property, financial transactions, as well as capital transactions (purchase and sale of shares etc.)

In evaluating controlled transactions, although ideally, the arm’s length principle is applied on a transaction-by-transaction basis, in practice, separate transactions may be so closely linked or continuous that they cannot be evaluated adequately on a separate basis.

Scope of the TP Instruction

Where related parties derive profits at a level above or below the comparable market level, solely due to the special relationship between them (e.g. by charging higher or lower prices compared to market prices), profits do not reflect the true value that would be derived in comparable market conditions.

Should the above be the case, the Tax Administration of Kosovo (TAK) has the right to make adjustments to the taxable profit of a CIT taxpayer to reflect the profit that would otherwise be derived in comparable market conditions between independent parties (i.e. arm’s length).

Thus, the TP instruction ultimately serves to provide guidance to both taxpayers and TAK in demonstrating that the taxable profit of a Kosovo CIT taxpayer is not affected by its special relationship with its related parties.

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Starting from FY 2017, CIT taxpayers may be subject to the following two requirements (i) preparation of TP documentation and (ii) submission of the Annual Notice on controlled transactions

TP Documentation

Taxpayers are given the initial burden of proof regarding the arm's length nature of their related party transactions. Starting from Fiscal year 2017, taxpayer involved in related party transactions are required to prepare TP documentation containing the minimum elements foreseen in the TP Instruction.

1. Summary of activities and organizational scheme of the taxpayer;
2. Description of the organizational and operational structure of the group in which the taxpayer is a member;
3. Description of the controlled transactions and applicable TP policies;
4. Explanation of reasons why a certain TP method and financial indicator were chosen;
5. Comparability analysis;
 - o Description of the process carried out to identify comparable transactions;
 - o Explaining the basis for the rejection of any potential internal comparable transaction, and a description of comparable transactions;
 - o Comparability analysis of controlled transactions and comparable uncontrolled transactions;
 - o Details and explanation of each adjustment performed on comparability.
6. Explanation of the economic analysis;
7. Details on any preliminary agreement regarding the pricing arrangement;
8. Conclusion regarding compliance with the arm's length principle.

Failure to prepare documentation in line with the TP Instruction and failure to submit will result in administrative penalties.

However, the most significant risk from failing to prepare and submit TP documentation is from TAK conduct their own analysis.

TP Documentation - Continued

The documentation content outlined previously provides the minimum required elements for fulfilling local documentation requirements.

Alternatively, documentation prepared in accordance with EU Code of Conduct and its annexes on transfer pricing documentation, and OECD TP Guidelines (BEPS Action 13) is also deemed to fulfill local requirements. Such documentation includes at least the following:

- Masterfile - This file is generally prepared by the group's headquarter and provides an overview on the activities of the group, as well as significant inter-company pricing arrangements.
- Localfile - specifically tailored to address the inter-company transactions of a local entity.

The files together constitute TP documentation, and both are submitted to tax authorities upon request.

Deloitte encourages taxpayers to inform group headquarters regarding the entry into force of the TP instruction.

It is highly probable that a Masterfile has already been prepared, and other group members may have prepared a Localfile. Obtaining any of the above files could reduce a taxpayer's burden for TP documentation compliance.

Submission of TP Documentation

TP documentation shall be made available to TAK 30 days upon request.

The documentation shall be submitted in one of the official languages of Kosovo, and, in certain circumstances, TAK may accept documentation prepared in English.

Note that taxpayers are not required to submit their TP documentation to TAK automatically as is the case in certain jurisdictions.

In addition to preparing TP documentation, taxpayers involved in related party transactions exceeding EUR 300,000 in a given fiscal year must submit to TAK a notice on their annual controlled transactions.

Annual Notice

Taxpayers involved in related party transactions exceeding EUR 300,000 must submit to TAK a notice on their annual transactions with related parties.

The annual notice has to be submitted along with the annual CIT return and statutory financial statements.

Annual Notice

The first annual notice on related party transactions will be submitted within 31 March 2018. A sample of information to be provided in the Notice includes:

- Information on the related party;
- Activity Code (NACE code);
- Amount;
- TP Method used;
- Whether Documentation has been prepared.

Additional information is required for loans and capital transactions.

Notice that taxpayers with related party transactions below EUR 300,000 are not required to submit the Annual Notice on Controlled Transactions.

TP Methods

Taxpayers are required to choose the most appropriate method to determine the arm's length nature of their related party transactions. The TP Instruction prescribes the following methods:

- Comparable uncontrolled price method;
- Resale price method;
- Cost plus method;
- Transactional net margin method (TNNM);
- Profit Split Method.

Taxpayers must explain the reason for choosing a particular method in their TP Documentation.

Comparability Analysis

In the process of identifying comparable transactions between independent parties, taxpayers must take the following into account: (i) characteristics of good/service/property being compared, (ii) functions performed and risks assumed, (iii) contractual arrangement, (iv) economic circumstances as well as (v) business strategy.

All of the above five factors must be taken into account in the process of identifying comparable transactions.

Comparable Data Sources

The TP Instruction allows the use of two sources for comparable data.

(i) Internal comparable
Includes transactions between the taxpayer and a third independent party, which are comparable to the transactions with the related party.

Notice that internal comparable transactions, if available, are usually considered more reliable for TP purposes

(ii) External comparable
Includes comparable transactions between two independent parties. External comparable transactions can be domestic (within Kosovo) or foreign.

In practice, it is rather difficult to identify external comparable transactions within Kosovo due to lack of publicly available information. Hence, external comparable transactions are usually identified in other geographic markets (EU or Balkans).

Final Considerations

TP documentation prepared for a particular fiscal year, will also serve as a basis for the upcoming years if the transactions are of a recurring nature, and the economic conditions do not change significantly. However, if a search for external comparable transactions is necessary, then the following apply:

- For taxpayers exceeding EUR 300,000 in controlled transactions within a fiscal year, the financial results (financial indicators derived from the search for external comparable transactions) must be updated on a yearly basis. Whereas a complete new search for comparable transactions shall be performed every three years.
- On the other hand, taxpayers with controlled transactions below EUR 300,000 do not need to update the financial indicators every year. However, the requirement to perform a new search for external comparable transactions every three years remains.

2. Fiscal Package 2.0

The Government of Kosovo Approves Fiscal Package 2.0

What is Fiscal Package 2.0

Fiscal Package 2.0 is a series of measures that the Government of Kosovo will incorporate into the legislation in response to needs and requests from local businesses.

The most significant measures of this package in particular address the needs of local producers to become more competitive in the regional and international markets.

This package includes a total of 22 measures that tackle different tax areas including excise tax, value added tax, tax breaks as well as other non-tax measures intended to ease the process of doing business in the country.

Approval and Implementation

After many discussions and several ongoing postponements, the Government of Kosovo finally approved the New Fiscal Package 2.0 on July 17th 2017.

The measures of the Package will be gradually implemented over the coming months.

Please note that there may be delays in the implementation of the outlined measures due to political reasons.

Certain measures were supposed to be implemented in July but their implementation has been delayed.

📞 For further information please contact us.

Description of Measures

In this section we have included a description of each measure of the fiscal package as well as the month foreseen for the implementation of each respective measure. Notice that certain measures were supposed to be implemented in July but their implementation has been delayed. We have provided this information in tabular form.

Measure of the Package	Entry into Force
1. Exemption from customs duties for all products considered as raw material for production, in accordance with the TAK producers register	October 2017
2. Abolition of excise tax rate on heavy oil for production	July 2017
3. Modification of the list of products subjected to the 8 percent reduced rate of VAT for cultural, artistic, sports, touristic activities, accommodation and recreation and fish processing.	September 2017
4. Issuance of the Administrative Instruction on Tax Holiday intended to encourage investments in strategic sectors (agro-processing, tourism and IT) for a certain period of time	September 2017
5. Issuance of the legislative act on the special conditions for the identification, control and marking of flour which is placed in free circulation in the market in Kosovo	July 2017
6. Issuance of a sub-legal act for certain conditions under which losses from the breakdown, evaporation or loss of the weight of oil and its products are recognized, with the possibility of recognizing weight loss for other products as well.	July 2017
7. Creating new tariff codes for some products, according to EU practices	Ongoing

Measure of the Package	Entry into Force
8. Create a rating list of companies	Reviewed on annual basis
9. Licenses - creating a transparency portal in order to address business requirements for different licenses (transport, export, exploitation, etc.)	July 2017
10. Fiscalization - advancing the fiscal system through a new IT platform	January 2018
11. Review of the Law on Games of Chance in order to harmonize it with best international practices with the aim of achieving better monitoring and complete formalization of this sector	September 2017
12. List of domestic producers - issuance of authorization procedures for local producers, who can benefit from all the exemptions for inputs and machinery used in the production process.	Reviewed on annual basis
13. Amendments to the Law on Corporate Income and the Law on Personal Income to address the taxation of insurance companies and the reduction of the withholding tax for agricultural product collectors	January 2018
14. Supplementation of the VAT Law to address A) taxation on the activities of international road transport of passengers in order to ensure equal treatment with the international airway and railway transport of passengers B) Tackling of special schemes for investment gold so that the VAT will be calculated only for the part of labour spent on jewelry, whereas pure gold will not be part of the taxable value	January 2018
15. Handling the import of mobile phones through increased and joint activities of Tax Administration of Kosovo and Kosovo Customs	September 2017
16. Market regulation of on-line sales. KC with a new platform for the control the sales.	September 2017
17. Reduce excise tax on carbonated and non-carbonated drinks	September 2017
18. Treatment of import of partial-form manufacturing equipment	September 2017
19. Excise tax on ethyl alcohol for use in medicine	September 2017
20. Treatment of samples on the occasion of customs clearance	Ongoing
21. Issuance of the Administrative Instruction for the Special Investment Gold Scheme and taxation only for processing and not for gold trading	January 2018
22. Maintaining fair competition through reviewing potential monopolies in the market by setting up an inter-ministerial Commission to review business complaints on potential monopolies in the market.	Ongoing

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