

## Tax & Legal Alert

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### I. Public Explanatory Decision No. 1 / 2014 for Taxable Income from Long-term Construction

The intent of this Public Explanatory Decision is to clarify the tax obligations and the manner of declaration and payment of Value Added Tax (VAT) and Personal Income Tax, respectively Corporate Income Tax, for the taxpayers engaged in long-term construction contracts and projects that are subject to Article 6 of Administrative Instruction no. 13/2010 respectively Article 4 of Administrative Instruction no. 14/2010.

The document firstly makes the distinction between the taxpayers that are impacted by this decision, as follows:

- *Constructors* – those who perform the construction work
- *Investors* – those who finance the construction contract work
- *Constructor/ Investor*- those who both finance and perform the construction contract work

#### Value Added Tax

The Public Explanatory Decision clarifies the legal base of VAT calculation during the period 01.07.2001 until 30.06.2010. For the period defined above, when taxable persons perform both taxable supplies and exempt supplies of goods or services they are required to estimate the Tax Credit Coefficient (TCC). The formula to

be applied is:  $TCC = \text{Taxable supplies} / (\text{taxable supplies} + \text{exempt supplies})$ . Due to specific nature of this economic activity, TAK had issued Instruction for 'Construction Enterprises' on 30.06.2006 that explains how to use the TCC. The public explanatory decision further demonstrates the treatment through an example.

The Public Explanatory Decision also defines the legal base of VAT calculation after the Law no. 03/L-146 (01.07.2010) became effective. Exemptions for the supply of houses, apartments or other accommodation used for a relevant residential purpose are foreseen through Article 28 of the Law no. 03/L-146. Further, Article 39 foresees the calculation of the deductible proportion of input VAT based on real use that was done. Deductible Temporary Proportion (DTP) of VAT is calculated based on transaction from the previous year or based on taxable person's own prognosis. The actual formula to be calculated is:  $DTP = \text{Taxable Supply} / (\text{Taxable supply} + \text{excluded supply})$ . The proportion should be determined annually as a percentage and it should be rounded in an integer that follows. At the end of the tax period of January of the following year the DTP should be adjusted to reflect the actual deductible proportion. TAK should be notified for the method of determination at least 15 days before the period starts. Further, Article 28, paragraph 1.10 and 1.11 of the Law 03/L-146 TAK concurs that garage supply (in residential buildings) is not exempted from VAT which means that it is a taxable supply. However, exemptions apply when the garage is inseparable part of the residential building and cannot be bought separately. Model examples are given to further illustrate the treatment.

### **Recognition of income and expenses (costs) in long term- contracts**

Article 5, Paragraph 5, Law No. 03/L-162 on Corporate Income Tax states that taxpayers engaged in long-term construction contracts and project shall report the taxable income in a manner prescribed in a sub-legal act issued by the Minister.

'Constructors': Article 4, paragraph 3.1 of Administrative Instruction no. 14/2010 specifies that *constructors* are required to use the 'percentage of completion cost estimate' where the reported income and expenses are based on the proportion of the construction that is completed based on the proportion that contract expenditures incurred for work performed to date bear to the estimated total contract expenditure. Further, Article 4 of Administrative Instruction No. 14/2010 requires that the billing for percentage of work performed to be done until the end of a tax period/year.

'Investors' and 'constructor/ investors': Article 4, paragraph 3.2., of Administrative Instruction 14/2010 states that the taxpayers falling under the definition of 'Investors' and 'constructor/ investors' are required to use the 'income taxed as accrued' method where income is reported on the basis of payments accrued (where there are receipts and/or an entitlement to receive based on a contract) and expenses are proportionately allowed on a similar basis.

Paragraph 3.3 of Article 4 requires that upon completion of a construction contract by the taxpayers that fall under these categories there are parts of the construction that remain unsold, where the income from such sales (and their associated expenses) have not yet been recognized, the value of such unsold parts shall be recorded as inventory of the investor or constructor/investor and be recorded on their balance sheet until sales take place.

The Public Explanatory Decision clarifies the recognition of revenues in installment payments after the project completion by defining the following moments:

- Adjustments in income should reflect the changing of method in accordance with the new applicable Law if the taxpayer has submitted advances before Law 03/L-162 became effective;

- All submitted advances and payment installments while the building is under construction should be recognized as revenues in the year when they are submitted and expenses should be recognized in that proportion as well; and,
- When the property is given for use, the remaining part (unpaid part that is expected to be paid with installments during the following years) will be recognized as revenue, despite the fact that the collection will be done based on the contract during the following years because the property is not at stock but it is sold.

Following the clarification of the legal base, examples are given to illustrate the treatments.

This Public Explanatory Decision is effective from 14<sup>th</sup> March 2014.

## **II. Public Ruling No. 02/2014 on the Procedures for the Transfer of Ownership / Change in Business Form**

The purpose of this public ruling is to offer additional information to taxpayers/businesses who are interested in changing the form of the business or the business ownership.

A taxpayer must apply to Kosova Business Registration Agency (KBRA) and also to Tax Administration of Kosova (TAK) to change the business form or ownership.

First, a taxpayer must submit the request for the change of business form/ownership to KBRA together with:

- Completion of form B,
- Copy of owner's (owners') ID,
- Original business certificate
- Agreement between partners (if it is a general partnership)

Second, if the request is approved, the taxpayer together with protocolled documents by KBRA must visit TAK respective regional office for

taxpayer's services and submit an application for Tax Verification for the change of business form/ownership purpose.

The request for Tax Verification must be accompanied by these documents:

- Copy of Fiscal Number Certificate
- Copy of VAT Certificate
- Copy of owner's/manager's ID or copy of the authorization from owner/manager for the representative
- The overall tax position of the taxpayer on the date of application
- Copies of unprocessed tax declarations/reminder letters

According to the public ruling, in order for a business to be able to change its form or ownership, that business must submit tax declarations and fulfill tax liabilities for all tax periods. Thus, only after that, TAK will issue Tax Verification which enables a business to change the business form or ownership.

Within 15 days the taxpayer will be informed whether he is entitled to receive the Tax Verification. The taxpayer must submit the original Fiscal Number Certificate and original VAT Certificate in order to withdraw the Tax Verification.

After receiving the Tax Verification, the taxpayer within 7 days must visit KBRA and initiate the procedures for the registration of the new business. A new Certificate of Registration will be issued, containing the new/old business registration number and new/old fiscal number. The closing date will be automatically imposed to the old taxpayer by TAK and any VAT crediting right may be reimbursed or transferred to the new taxpayer.

The public ruling will become effective from 20<sup>th</sup> March 2014.

### **III. Law No. 04/L-220 On Foreign Investment**

This law serves the purpose of protecting foreign investments and ensuring foreign investors the fundamental rights and guarantees that their investments will be treated fairly and in accordance to international practices.

Foreign investors who want to invest in the Republic of Kosovo are guaranteed a fair treatment in accordance to the legislation of the Republic of Kosovo and generally accepted norms of international law.

A foreign investor has the right to resolve his/her investment disputes before a competent court in the Republic of Kosovo or through the local or international arbitration. Unless parties to the dispute have agreed with laws or substantive rules to apply in case of a dispute, the applicable law of the Republic of Kosovo should be applied. Any arbitral award decided upon in relation to the investment dispute will be enforceable within the Republic of Kosovo equivalently to the final decision of the highest court of the Republic of Kosovo.

The Kosovo Investment and the Enterprise Support Agency are institutions responsible for protecting and promoting investments, and supporting the application of public policies for Micro, Small and Medium Enterprises (MSME). These institutions will work toward creating a suitable environment for the development of MSME-s with the help and coordination of the Government of the Republic of Kosovo.

### **IV. Amendment of the Law no. 03/L-229 on Protection of Competition**

Pursuant to this amendment, the term "Agreement" shall mean:

Agreements of any kind concluded between enterprises, with or without binding force, decisions or recommendations of groups of enterprises, as well as coordinated practices

between enterprises that operate at the same level, or at different levels of market.

While, the term "Business Entity" shall mean: Any business activity, regardless of organization manner or management form, public entrepreneurs are established to carry out activities for public interest and any other natural or legal person or state authority that carries out economic activities regardless of the fact if it is considered a business subject or not.

#### **Ascertaining Dominant Position**

The amendment made to the Article 10 of the basic Law specifies that the percentage of the dominant position has been changed from forty percent (40%) to twenty five percent (25%).

Furthermore, this article is reformulated by specifying in more details that two or more enterprises may be in a dominant position if, in relation to their competitors, they operate jointly on the relevant market and if their general market share is higher than forty percent (40%) (Collective dominance position). With respect to the ascertaining of the dominant position issue, this amendment specifies that this burden shall belong to the respective authority.

#### **Competent Court for Administrative matters**

According to the amendment, any disputes deriving from article 17 to 20 of the basic Law, the Court for Administrative matters will be the competent one.

#### **Punitive measures**

After article 56 of the basic Law, a new article is added regarding the fines for responsible persons in case they are involved in violations specified in articles 56 and 57 of the basic Law.

If a person who is in charge of the enterprise or the state body is involved in violations mentioned in the above articles, such person shall be fined in the amount of one thousand (1000) Euros up to three thousand (3000) Euros.

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