

Income flat tax rate system in Albania | BY MIRJETA EMINI AND JONIDA SKENDAJ

Establishing tax incentives for foreign and local investors is always the best way to increase investments. The initiative of the government to increase investments in Albania was cemented by decreasing the tax rate to 10 percent for all income of investors, whether business (e.g., profit tax) or personal (e.g., dividends).

Overview of taxation of corporations under profit tax

Branches of foreign corporations or their subsidiaries having their place of activity in Albania (registered in Albania) are subject to profit tax.

Corporations conducting business in Albania became subject to a profit tax at a flat rate of 10 percent starting from 1 January 2008. Previously, the rate of profit tax was decreased from 25 to 23 percent for 2005 and to 20 percent for 2006 until end of 2007.

In recent years, apart from decreasing the tax rate, the Albanian government has not made significant and encouraging changes to the methods for calculating profit tax.

Determining taxable profit starts with the profit shown in the income statement. The calculation of profit should be performed in accordance with the accounting legislation in force and the relevant instructions of the Ministry of Finance.

The Albanian accounting rules have recently changed, too. From 1 January 2008, and subject to specific requirements, corporations may apply IAS/IFRS (International Accounting Standards/International Financial Reporting Standards). If the specific requirements are not met, the local standards that are in line with IFRS are applicable.

But this change to accounting standards has not been followed by tax adjustments. Therefore, where the accounting treatment has changed for a specific income or expense, the relevant tax treatment is not updated accordingly. This leads to confusion over the tax treatment of an income or expense. Gaps arising from lack of reconciliation between accounting and tax treatment have not been remedied.

The Income Tax Law (law no. 8438, dated 28 December 1998, as amended) and relevant Instruction of Minister of Finance constitute the tax legal framework for the determination of taxable profit.

Albanian fiscal legislation provides the general rules of deductibility of expenses for profit tax purposes. An expense is deductible if it is incurred in the direct interest of the taxpayer and relates to the activity of the taxpayer. It must be supported with legal and fiscal documentation (such as the contract and regular tax invoice and any other document evidencing that it is effective).

In addition, the Income Tax Law and Instruction set out a list of expenses considered as tax non deductible.

The fiscal legislation recognises the depreciation allowances to the owner of the assets. In the case of finance leasing, depreciation may be claimed by the lessee, being the person who bears the risk of the loss or destruction of the asset. Such legislation provides for the methods and rates of depreciation of tangible assets and amortisation of intangible assets for fiscal purposes (i.e., straight-line method and pooling system).

Inventory may be assessed using the weighted average price method, FIFO, or any other method specified in the local accounting standards/IFRS, provided that the corporation uses the same method consistently. Any subsequent measurement of the inventory after the initial recognition is not considered for profit tax purposes.

Provisions are not allowed deductions for tax purposes, except for the banks and insurance companies.

Losses may be carried forward for three consecutive years provided that there is no change of more than 25 percent in the ownership of share capital of the taxpayer.

Tax inspectors are entitled to adjust the profit arising from a transaction between related parties if the parties have engaged in a transaction that has conditions which differ from those of a similar transaction between unrelated parties.

For profit tax purposes, Albanian fiscal legislation recognises the crediting of the tax paid abroad by Albanian residents, either individuals or entities.

Overview of the taxation of foreign corporations under withholding tax

Foreign corporations that do not have a fixed place of business in Albania but render specific services to Albanian entities are subject to withholding tax in Albania at 10 percent of the gross amount of payments.

According to Income Tax Law, Albanian residents should withhold and pay to the tax authorities the withholding tax at 10 percent on the gross amount of the following payments: (i) technical, management, financial and insurance services; (ii) management and participation in board of directors or directing councils; (iii) payments for constructions, instalment, assembling or supervising work that relate to such activities; (iv) rental payments; and (v) payments for performance of actors, musicians or sportsmen, including payments of the same nature made to persons that employ artists or sportsmen or act as intermediaries in arranging shows or performances

In addition, foreign corporations are subject to the withholding tax for payments made in their favour and consisting of dividends, profit shares, interests and royalties. In these cases, the Albanian taxpayers are required to withhold the tax on such income and transfer it to the tax authorities' bank account not later than the twentieth day of the month following the month when the payment of the income occurred.

Exceptionally, the withholding tax for services rendered by non-resident companies or individuals should be paid to the tax authorities' account before the end of the fiscal year (i.e., 31 December), although the payment of the relevant invoice is not executed. Should the Albanian resident fail to withhold and transfer the above tax to the tax authorities, the expense will be considered as tax non-deductible.

It should be noted that based on the tax practice in Albania, and the Instruction of Minister of Finance on Income Tax, all payments made by Albanian taxpayers to entities or individuals not registered with the tax authorities are subject to withholding tax, despite the fact that the

nature of these payments does not fall into the categories of withholding tax payments subject to the Income Tax Law.

The withholding tax shall not be applied when payment is made to: (i) legal entities or individuals that are tax-registered businesses in Albania (thus, entities subject to Albanian profit tax or personal income tax), which include the payment in their taxable income; (ii) non-resident entities, for payments related to the international transport of goods and passengers; and (iii) domestic dividends received by a resident company.

Additionally, according to Instruction of Minister of Finance on Income Tax, no withholding tax is applied on payments made to non-residents for supply of services rendered entirely outside Albania, provided that this fact is evidenced with related financial and technical documentation. In any case, the final decision on exemption from withholding tax shall be made by the General Tax Directorate, on a case by case basis.

As mentioned above, withholding tax at the 10 percent rate is applicable on dividends distributed from an Albanian company (subsidiary) to its foreign shareholder. On the contrary, such tax is not applicable in the case of a transfer of profit realised in Albania by a foreign corporation through a branch. Such profit may be freely transferred after payment of profit tax.

As regards the taxation of dividends, the Income Tax Law provides that within six months from the end of each calendar year, the shareholders' assembly or the competent decision-making body of the com-

pany should approve the financial results of the previous year and decide on the destination of profit. If the shareholders' assembly decides to distribute dividends, then the withholding tax on dividends should be paid to the tax authorities' account no later than 30 July, notwithstanding the fact that the effective payment of such dividends may not have been executed by that date.

Overview of double tax treaties on avoidance of double taxation on income and capital

The above taxation rules and rates apply when treaties on avoidance of double taxation on income and capital are not in force or do not otherwise provide.

Albania has entered into treaties for the avoidance of double taxation on income and capital with 27 countries. These treaties may provide for exemption from taxation or reduction of the tax rate applicable to the income generated in Albania from non-resident entities or individuals.

When the provisions of tax treaties apply, the Albanian taxpayer should follow the required procedure with the General Tax Directorate, in order to confirm the exemption or reduction of tax. ■

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