



Corporate Tax

First Edition

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Albania

Alketa Uruçi & Jonida Skendaj
Boga & Associates

Overview of corporate tax work

Our tax team offers strategic tax advice and provides effective strategies for tax problems. The tax services include the development of tax-efficient structures for corporations. The team provides ongoing advisory services to corporations on the impact of fiscal changes, and represents clients in tax litigation cases before all levels of the Albanian courts. The tax advisers also actively participate in the counselling and drafting of fiscal legislation. The team has wide experience in the areas of corporate tax.

Significant deals and highlights illustrating aspects of corporate tax

One of the most important issues discussed in terms of corporate income tax is the question of whether branches of foreign entities operating in Albania should pay tax on dividends for the net profit transferred to the parent company.

Albanian legislation does not provide for a tax on branches' profit. In addition, considering the definition of 'dividend' under the Albanian commercial law, the net profit transferred from the branch to its parent company does not have the nature of dividend- or profit-sharing and therefore should not be subject to any withholding tax.

Though the tax authorities have several times accepted the above logic and have not imposed any tax obligations on foreign branches in Albania, there have been sporadic occasions when this has happened, thus leaving room for uncertainty on this issue.

Key developments affecting tax law and practice

Corporate tax rules are established in Income Tax Law (law no. 8438/1998). The most important changes to the said law since its enactment in 1998 were passed during the first decade, affecting mostly the list of tax non-deductible expenses and the corporate tax rate. Although relevant changes have occurred, the legal framework of the corporate tax is well consolidated. However, the practice of tax authorities on the interpretation of such framework has changed in recent years. Tax authorities tend to make an assessment of whether the expense has an economic/profit rationale and if not, disregard the expense. The right of the tax authorities to go further in the assessment of tax-deductible expenses under the perspective of the new practice is not explicitly set forth in the law.

One of the cases where the tax authorities use such logic is their decision to disregard compensation for target performances.

They have considered that compensations paid for target performances (so-called bonuses) provided in a business-to-business relationship (e.g. a supplier to its distributor) are not deductible for VAT and corporate income tax purposes.

The arguments were that bonuses: (i) are marketing policies for commercial purposes but not fiscally recognised/acceptable, since they are not explicitly mentioned in the fiscal legislation; (ii) reduce the VAT effectively paid by the supplier; and (iii) are not directly related to the primary business activity of a taxpayer.

They totally ignore that bonuses are paid only in case the distributors achieve some targets (new contracts, new clients, etc.); hence, for the work performed. By means of the bonuses' remuneration, the distributors become eager to engage new business for the supplier. As such, bonuses are directly related to the business activity of the supplier aiming to generate larger income.

This issue remains unresolved pending a decision by the courts.

Another issue has been noticed recently. The Income Tax Law provides that "expenses for technical, management and consultancy services rendered from third parties that are not paid within the same year" shall be considered as non-deductible expenses for corporate tax purposes. On the other hand, and contrary to other legislations (such as Kosovo Income Tax Law), the said law does not state whether the said expense shall be deductible later on in the same year the expense is paid.

An Instruction of the Minister of Finance on Income Tax made a rational interpretation of the above law provision, since it states that the expense shall be deductible if either: (i) the invoice; or (ii) the withholding tax due on the above services rendered from non-residents, is paid within the year.

Tax inspectors have refused to apply the above said provision of the Instruction of Minister of Finance, on the grounds that the Ministry has exceeded its competencies and the said provision is in breach of the law. By doing this, taxpayers have been penalised for fully obeying a provision of the instruction issued by the Minister of Finance.

As a response to such practice of the tax inspectors, the government has proposed recently to amend the law provision (by clearly indicating that once the withholding tax has been paid within the calendar year, the deductibility of the expense is no longer questionable). This law amendment has been passed by the parliament. It will be effective once it is proclaimed from the President and published in the Official Gazette.

In addition, there are other recent positive changes to the Income Tax Law which are important to mention.

Losses by a taxpayer may be carried forward if the direct or indirect ownership of the share capital or voting rights of the taxpayer changes by 50% or less (such change could be viewed as an advantage to M&A transactions, considering the lower ceiling of 25% provided for previously).

Scholarships given to students and pupils, up to an amount to be specified by decision of the Council of Ministers, and provided that the institutions submit to the Ministry of Education and Science by the beginning of the academic year the envisaged number of scholarships and their respective amounts, are now recognised for corporate tax purposes. This brings to an end a long debate between certain private educational institutions and the tax authorities following the decision to reassess their profit tax declarations.

Attractions for holding companies

Holding companies can benefit from one of the lowest corporate tax rates in the region, i.e. the profit is taxed at a 10% rate. The net profit can be thereafter freely repatriated, being subject however to a withholding tax on dividends of 10%, which (rate) can be lower or zero if the profit is repatriated to a person resident in a country with which Albania has entered into a double tax treaty, and the said treaty contains such lower rate.

The corporate income tax system provides for a pre-payment of the tax in quarterly instalments by the 30th of the last month of the quarter, based on the profit realised in the two previous years. In the event the taxpayer is in its first year of activity, the instalments are calculated based on the forecast of the profit for the current year.

On March 31 of the following year, when all corporate tax subjects are required to file with the tax authorities their profit tax declaration for the previous year, the exact amount of the tax due is reconciled and the difference is paid to the state. Any tax paid in excess through instalments is carried forward or reimbursed.

Just as for VAT, the reimbursement of overpaid corporate income tax is made with a time lag by the Albanian tax authorities, which can affect the cash flow of the businesses.

Industry sector focus

The major industries in Albania are construction, telecommunications, minerals, energy & oil, food, textiles and footwear.

Most of the clients we have advised in relation to corporate tax issues are engaged in telecommunications, energy and oil, as well as the mining sector.

Deductibility of expenses related to the health insurance of employees working in hazardous work has been an issue for the mining sector. The tax authorities have considered such expenses as benefiting the employees personally, and as such not related to the business activity of the employer, although the insurance obligation is set forth in the law provisions as a legal obligation of the employer. Recently the court has accepted our client claim and considered the said expenses to be related to the business activity and as such tax-deductible, provided that they are justified with regular invoices.

The assessment of whether foreign service providers are obliged to register in Albania for corporate income tax or not still remains a challenge. Under the law provisions, an obligation for registration arises whenever the service provider has created a permanent establishment in Albania.

This assessment is less complicated when there is a tax treaty for avoidance of double taxation between Albania and the country of origin of the service provider. If no such treaty is in place, the assessment should be made under Income Tax Law provisions.

According to Income Tax Law, 'permanent establishment' means a fixed location of business where an entity carries out its business activity.

Specifically, the following are considered as permanent establishments:

- a) an administration office;
- b) a branch;
- c) a factory;
- d) a workshop;
- e) a mine, an oil or gas well, a quarry;
- f) any other place of extraction of natural resources; and
- g) a construction or installation site.

The said law provides for no minimum period of time for any of the above to be considered as a permanent establishment. Therefore, the project duration is irrelevant to the creation of a permanent establishment.

This affects cases where a foreign services provider would like to have short-term contracts with clients in Albania. They will tend to avoid registration, and therefore would not be willing to accept provision of services.

The year ahead

Developments are expected in terms of transfer pricing. The tax authorities are becoming more sensitive on transactions between related parties. Although a transfer pricing commission is provided for in the law, to be in charge of the assessment of such transactions, it is not effectively engaged. Activities undertaken recently by the tax authorities indicate that the commission will begin to be proactive, and many matters are expected to be referred thereto.

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Alketa is a Partner at Boga & Associates, which she joined in 1999.

The focus of her practice covers broadly concession and energy areas, where she manages energy assignments on any regulatory, corporate and commercial aspects, including in international arbitration proceedings.

Her experience includes regular tax advice to commercial companies, for corporate tax, VAT, employees' taxation matters, involvement in the management of several tax aspects of mergers and acquisitions transactions, tax planning and restructuring.

Alketa has performed a number of tax and legal due diligence assignments and managed legal consultancy to international clients. She has also assisted foreign clients during international arbitration proceedings and is active as a tax litigator in Albanian courts.

Alketa graduated in Law at the Law Faculty, Tirana University in Albania (1999) and in Finance at the Faculty of Economy, Tirana University in Albania (2004).

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Jonida is a Senior Associate at Boga & Associates, which she joined in 2004.

She is a specialised business lawyer and assists clients on any business law aspects, including corporate, employment, taxation of corporations, competition law implications, mergers and acquisitions and intellectual property. Jonida is also involved with assisting foreign investors in the energy field from the perspective of compliance with the energy regulatory framework and concessions.

Jonida graduated in Business Law ("*Maitrise en Droit des Affaires*") at the University of Paris X Nanterre, Paris, France in 2002 and obtained a Masters Degree in Business Law, focused on EU Competition Law ("*Diplome d'Etudes Approfondies en Droit des Affaires*"), in 2003 at the University of Paris X Nanterre, Paris, France.

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