



Pristine, 28 May 2009

Mr. Kjartan Björnsonn
Head of Operations
European Union Commission Liaison Office to Kosovo

Dear Mr. Kjartan Björnsonn,

I thank you for your feedback letter of 11 March 2009 – D(09)KB/axh396 - on the by the Tax Administration of Kosovo proposed procedure for the tax treatment of the EC contracts which are eligible under IPA programs.

From the content of your letter, we can conclude that the EC Liaison Office and the Tax Administration of Kosovo (TAK) are in agreement on how article 26 of the IPA agreement will be implemented in practice.

During our meeting with representatives of your office in the beginning of last April, TAK has explained that the VAT issue is in principle a Tax Administration issue and that the implementation of article 26 is not only related to VAT but that as well to profit/income tax and other taxes as explained in the attached implementation description. In addition, it is the international practice that as well diplomatic and consular missions are fulfilling the withholding obligations in respect of wages and pensions contributions of local employees as to avoid for these employees serious financial problems if having to pay taxes after submitting an annual Personal Income Tax for which no withholding on the wages was made in the course of the tax year. The same is valid for the pension contributions.

The final worked out rules – see the attached “Description of the implementation of article 26 of IPA agreement” - are taking into account all aspects of article 26 of the IPA agreement but as well the point that ECLO wants to manage the EC contractors directly in respect of the purchase authorizations of goods and services with request for VAT exemptions. The application form to be used by the EC contractors for requesting such purchase authorizations to ECLO is not dealt with in this description as this a pure internal issue between the EC contractor and ECLO.

On the other hand, the Tax Administration needs to manage the different levels of VAT, what means that it needs to have the possibility of verifying as well the correct implementation of

VAT at the level of the EC contractor. Therefore, necessary copies of documents as described in the description should be submitted to TAK as to realize that concrete goal.

Further, TAK can certainly agree for establishing an M.O.U with ECLO as to provide a legal basis to ECLO for issuing purchase orders with VAT exemptions.

TAK provided as well the necessary written clarifications to your representatives on the questions reflected in your letter of March 11, 2009 – D (09) KB/axh 396 during the April meeting.

We are looking forward to meeting with you or your staff to make the final arrangements.

Yours sincerely,

Naim Fetahu
General Director of the Tax Administration of Kosovo

Attachment: Description of the implementation of article 26 of IPA Agreement



DESCRIPTION OF THE IMPLEMENTATION OF ARTICLE 26 OF IPA AGREEMENT

I. Legal basis:

Sub-paragraph 1.3 of article 11 of the Law No. 03/L-114 of 18 December 2008 On Value Added Tax.

1. The text is the following:

“No value added tax shall be charged on imports or supplies, funded from the proceeds of grants, made to or for Ministries in support of humanitarian and reconstruction programs and projects in Kosovo”.

2. Meaning of sub-paragraph 1.3 of article 11 of the Law No. 03/L-114:

The meaning given to the text of this sub-paragraph is exactly the same as the meaning given to the text of Section 11, 1 (c) of the VAT Regulation No. 2001/11 On Value Added Tax in Kosovo as amended by different Regulations.

3. The text in the new draft VAT Law actually submitted to the Assembly:

The text¹ which is proposed in the new draft VAT Law which is currently treated by the Assembly in order to be introduced on 1 January 2010, is based on the text of Section 11, 1 (c) of the Regulation No. 2001/11 mentioned before.

The analytic text is the following:

“No value added tax shall be charged on

¹ It is stressed that in this text, the wording “other projects including European integration projects” is mentioned. The term “European Integration Projects” is defined as “Any project executing an EC contract by an EC contractor in the sense of article 26 of the IPA agreement that makes possible the implementation of projects for Instrument of Pre-Accession (IPA)”.

- “Imports or supplies
- funded from the proceeds of grants made to the budget or through the budget of Kosovo or under the supervision of competent bodies or financed by contracts
 - for the benefit of ministries, local authorities and other bodies governed by law
 - by
 - 1) international inter-governmental organizations and their agencies, governments, government agencies, governmental or non-governmental organizations in support of humanitarian and reconstruction programs; and
 - 2) other projects including European integration projects²
- in Kosovo”.

II. Description of the registration procedure of EC contractors:

1. Registration of local EC contractors:

The local EC contractors, who are not registered for business purposes in Kosovo, are subject to the rules in place for business registration followed by taxpayer registration including registration for VAT purposes.

The local EC contractor who is already registered for tax purposes shall submit a copy of the certificate of status of EC contractor within 5 days after starting activities as EC contractor.

A local EC contractor who is not yet registered for tax purposes shall submit a copy of the certificate of status of EC contractor (see Annex 1 of the attachment) at the moment of registration for tax purposes but prior to starting its activities as EC contractor.

2. Registration of external EC contractors:

- 2.1. The external EC contractors are immediately subject to a temporary registration for tax purposes including registration for VAT purposes with the Central Tax Authorities. Such registration must be followed by a business registration (eventually NGO registration) in accordance with the actual rules applicable on basis of Kosovo legislation. Such contractor shall also submit a copy of status of EC contractor at the

² The term “European Integration Projects” means any project executing an EC contract by an EC contractor in the sense of article 26 of the IPA agreement that makes possible the implementation of projects for Instrument of Pre-Accession (IPA).

moment of temporary registration or if already registered for tax purposes, within 5 days after starting activities as EC contractor.

2.2. The temporary registration with TAK serves certainly for the purposes of the fulfilling of tax obligations that such external EC contractors will have in respect of local employees such as making tax withholding on their salaries and the necessary pension contributions – the local employees are indeed subject to the Kosovo Personal Income Tax as imposed by sub-paragraph (2) c) of article 26 of the IPA agreement. This does not mean that an external EC contractor will be taxed on its or his business income earned in Kosovo, neither that he will be subject to VAT taxation.

2.3. Certificate of status of EC contractor: See Annex 1.

The certificate is established by ECLO in 3 copies (originals):

Original No. 1: One for the ECLO contract file

Original No. 2: One for the EC contractor

Original No. 3: One for the Tax Administration.

III. VAT:

Part 1: Procedure in respect of supplies of goods and services in Kosovo

1. VAT procedure:

Annex 2(1) – scheme: Description of the VAT procedure in respect of supplies of goods and services made **by** and **to** EC contractors within the context of EC contracts as defined in article 26 of the IPA agreement between the EU and Kosovo.

2. Purchases of goods and services by the EC contractor in Kosovo (see modified ECLO model Annex 3):

2.1. Purchase Order with request for VAT Exemption:

2.1.1. The EC contractor applies to ECLO for obtaining the form “Purchase Order with request for VAT exemption”:

The EC contractor applies to ECLO and obtains from ECLO the filled out form “Purchase Order with request for VAT Exemption” see modified Model **Annex 3** of the EU. The purchase order concept has already been developed within the context of by the Tax Administration “Procedure for excluded purchases of 20 November 2006”.

2.1.2 The purchase order with request for VAT exemption is established in 4 copies (originals):

Original No. 1: One for the ECLO contract file

Original No. 2: One for the EC contractor
Original No. 3: One for the sub-contractor/supplier of the EC contractor
Original No. 4: One for the Tax Administration

The EC contractor receives the originals No. 2, 3 and 4 and shall provide the original No. 3 to his supplier-sub-contractor and the original No. 4 to the Central Office of the TAK – Taxpayer Education Department.

2.2. Invoices

2.2.1. Invoices issued by the EC contractor to ECLO:

The EC contractor issues invoices in respect of supplying goods and services under an EC contract to the European Commission Liaison Office to Kosovo (ECLO) respecting the fundamental content principles of the Kosovo VAT Law³ where applicable (Administrative Instruction No. 1/2004, dated September 1, 2001 on Implementation of value added tax – Section 12).

These invoices are issued on the name and address of ECLO.

The EC contractors don't charge VAT on these invoices on basis of sub-paragraph 1.3 of article 11 of the Law No. 03/L-114 of 18 December 2008 On Value Added Tax.

The EC contractors, not mentioning VAT on these invoices, are obliged to indicate the reason of exemption. Therefore, the following text shall be mentioned: "The supply of goods services including works, are exempted under sub-paragraphs 1.3 and 1.5 of article 11 of the VAT Law No. 03/L-114 of 18 December 2008: No VAT charged by EC contractor + <contract title> + <contract number> + <reference data of the purchase order with request of VAT exemption>.

2.2.2. Invoices issued by the suppliers and sub-contractors of an EC contractor to that EC-contractor.

The suppliers and sub-contractors of the EC contractor do neither charge VAT to the EC contractors on basis of the "Procedure for VAT excluded purchases of 20 November 2006". No VAT is charged on these invoices and the suppliers and sub-contractors of the EC-contractors are obliged to mention the reason of zero rating which is in fact an exemption with VAT input deduction right for the EC contractor.

Therefore, the following wording shall be mentioned by the sub-contractors on their invoices issued to the EC contractor: "The supply of goods services including works, are exempted under sub-paragraph 1.3 of article 11 of the VAT Law No. 03/L-114 of 18

³ The current Kosovo VAT Law is based on the principles of the EU Sixth Directive.

December 2008 + Procedure for excluded purchases of 20/11/2006: No VAT charged to IPA-EC contractor + <contract title> + <contract number> + <data of the purchase order with request for VAT exemption>.

2.2.3. It is strengthened that the suppliers and sub-contractors of the EC contractors are subject to the normal VAT rules: the purchases which they acquire must be charged with VAT but the supplies of goods and services which they make to EC contractors are charged at zero rate (EU terminology: exempted supplies to EC contractor with VAT input deduction right) – they can thus take their input VAT deduction right in their VAT returns and their VAT refunds are falling under the normal VAT rules of implementation and audit.

2.3. VAT at the stage of the EC contractor in respect of EC contracts.

The balance (output VAT – input VAT) in respect for the domestic purchases of goods and services **will thus always be zero at the stage of the EC contractor** - the worked out procedure is automatically meeting all requirements of sub-paragraph (2) (b) of article 26 of the IPA agreement (no submission of VAT returns, no VAT refunds claims to be made).

2.4. VAT at the stage of suppliers and sub-contractors of EC contractors.

The suppliers and sub-contractors are subject to the normal VAT rules: the purchases which they are making are chargeable with VAT but the supplies of goods and services made to EC contractors are charged at zero rate (EU terminology: exempted supplies to EC contractor with input deduction right). The suppliers and sub-contractors can thus exercise their input VAT deduction in their VAT returns and their VAT refunds are falling under the normal VAT rules.

Part 2: Procedure in respect of import of goods into Kosovo.

1. VAT procedure:

Annex 2 (2) – scheme: Description of the VAT procedure in respect of imports of goods made within the context of EC contracts as defined in article 26 of the IPA agreement between the EU and Kosovo.

The import of goods by the EC contractor in respect of EC contracts are exempted from VAT on basis of the sub-paragraph 1.3 of article 11 of the VAT Law No. 03/L-114 of 18 December 2008 on which the agreed procedure made between ECLO and the Kosovo Customs for the purposes of the implementation of IPA between the EU and Kosovo has to be based.

The exemption of VAT at the border is a fundamental issue to be dealt with by the Tax Administration of Kosovo (TAK) like in any EU Member State and arranged by VAT legislation. The further administration after the exemption at the border is indeed a pure Tax Administration issue. Therefore, TAK needs to be informed from the very beginning of starting the procedure for exempting imports of goods of EC contractors in respect of EC contracts: it is indeed not only an issue of whether or not paying VAT at the border, it is as well an issue of the real use of these goods for the exempted purposes (in this case, so called excluded purposes), not exercising VAT input deduction right in the VAT return for the exempted imports, revision of the exemption if the goods, in particular capital goods are not or no longer used for the purposes which they were originally scheduled for or eventually sold.

An EC contractor who wants to import goods for the purposes of an EC contract should exactly follow the principles of the procedure as explained under part 1 before.

2. Imports of goods made by EC contractors into Kosovo:

The procedure is exactly following the same concept as mentioned under III, part 1, 2 before and the purchase order only relates to the implementation of the sub-paragraph 1.3 of article 11 of the VAT Law No. 03/L-114 of 18 December 2008 in respect of not charging VAT on the imports made by EC contractors in respect of EC projects.

2.1. Purchase Order with request for VAT Exemption for import:

2.1.1. The EC contractor applies to ECLO for obtaining the form “Purchase Order with request for VAT exemption” for import:

The EC contractor applies to ECLO and obtains from ECLO the filled out form “Purchase Order with request for exemption” for import – see modified Model Annex 3 of the EU. The purchase order concept was already developed for the implementation of the “Procedure for excluded purchases of 20/11/ 2006”.

2.1.2. The purchase order with request for VAT exemption is established in 4 copies (originals):

Original No. 1: One for the ECLO contract file
Original No. 2: One for the EC contractor
Original No. 3: One to present to the competent Customs office
Original No. 4: One for the Tax Administration.

The EC contractor receives the originals No. 2, 3 and 4 and shall provide the original No. 4 to the competent Customs office and the original No. 4 to the Central Office of TAK.

- 2.2. Single Administrative Document (SAD) in respect of an import of goods made by an EC contractor for EC contract purposes.

The following text shall be mentioned on the SAD document: No VAT charged by the Customs + <contract title> + <contract number> + <reference data of the purchase order with request for VAT exemption>.

- 2.3. VAT at the stage of import of goods made by an EC contractor in respect of EC contracts.

There is no VAT input to be offset as no VAT is charged by the Customs at the border if the SAD document is established on the name of the EC contractor.

- 2.4. VAT at the stage of import of goods made by suppliers and sub-contractors of EC contractors in respect of the execution of EC contracts.

The suppliers and sub-contractors of EC contractors are not exempted from VAT when importing goods for the needs of EC contracts. This also means that the import VAT paid at the border is deductible in the VAT return. But the supplies of goods made to EC contractors are zero rated. The suppliers and sub-contractors of EC-contractors can thus exercise their input VAT deduction in VAT returns and their VAT refunds are falling under the normal VAT rules.

IV. Taxes other than VAT

1. Income:

Income arising from EC contracts to EC contractors operating in Kosovo shall be taxable in Kosovo in accordance with the direct tax legislation of Kosovo (Personal Income Tax and Corporate Income Tax). However, natural and legal persons, including expatriate staff, from the Member States of the European Union or other countries eligible under IPA (excluding Kosovo), executing Community financed contracts shall be exempted from those direct taxes in Kosovo.

2. Withholding taxes on wages by virtue of article 17 of the Law No. 03/L-115 On Personal Income Tax:

- 2.1. Each natural and legal person–EC contractor - thus as well including those EC contractors from the Member States of the European Union or other countries eligible under IPA and as well including Kosovo itself - employing local staff, shall as employer withhold tax from the gross income from wages of his local employees during each payroll period and shall submit a statement of tax withholding within 15 days after the last day of each calendar month.
- 2.2. Such EC contractor – employer as referred to in 2.1 before, shall as well submit an annual tax reconciliation statement by 31 January of the year following the tax period.
- 2.3. Such EC contractor – employer as referred to in 2.1 before, shall provide by 1 March of the year following the tax period to every employee from whom wage tax has been withheld a certificate of tax withholding.

3. Pension contributions by virtue of the law No. 03/L-084 amending UNMIK Regulation 2005/20 amending UNMIK Regulation 2001/35 on Kosovo Pension Trust.

- 3.1. Pension contributions for the employees are withheld by the employer on monthly basis at the minimum rate of 5% on the gross wages of the employee. The employer contributes as well 5% for the employee which is also calculated at 5% on the gross wages of the employee. Employers and employees may voluntarily contribute an additional amount up to 10% of gross wages. Payment is made with a special statement, in one of the banks that operates in Kosovo and which are licensed by the Central Bank.
- 3.2. Five (5%) + the eventual voluntarily ten (10%) that the employer contributes for the employee, can be deducted by the employer as a direct expense for the purpose of income tax. Such expense needs to be deducted in the country of the EC contractor because he doesn't file an annual Income Tax declaration in Kosovo.
- 3.3. Five (5%) + the eventual voluntarily ten (10%) that the employee contributes, will be deducted from his gross wages. The remaining balance after these deductions will compose the taxable base on which the applicable tax rates are implemented.
- 3.4. Employers are also required to submit a quarterly statement of the contributions which they withheld on the gross wages of their employees.

You can download all tax forms from the Web-Site of the Tax Administration
www.atk-ks.org

V. Other accounting and payment obligations

1. Accounting records of the EC-contractor and bank payments to suppliers and sub-contractors:

- 1.1. The EC contractor keeps separate accounting and records for EC contracts. He *shall produce a monthly list of the invoices issued to him and the validated SAD documents and* certify their authenticity and submit these lists to the regional Tax Office.

He shall also keep a journal on a daily basis for the follow-up of the use of its purchases and his imported goods and the completion of long term contracts such as building sites or construction or installation projects if such is the case. The term “building site or construction or installation project” includes not only the construction of buildings but also the construction of roads, bridges or canals, the laying of pipe-lines and excavating and dredging. Such contracts shall be regarded at least completed at intervals at the end of each calendar year.

- 1.2. The EC contractor shall make all payments to suppliers and sub-contractors through banks and keep copies of these bank payments.

CERTIFICATE OF STATUS OF EC-CONTRACTOR (Annex 1)

Issued by the competent ECLO Authority or its representative for the needs of the Tax Administration of the Republic of Kosovo (article 26 of the IPA agreement)

The undersigned (Name, address ECLO authority + name and position of the person who certifies)

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.....

certifies that

(Full Name or Corporate Name and address of EC contractor in Kosovo and in his country of origin if applicable + name and address of the responsible representative in Kosovo):

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.....

is EC contractor - article 26 of the IPA Agreement of the EC contract (contract title – Date – contract number – Place and address of project execution)

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.....
.....

Short description of executed activities

.....
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.....

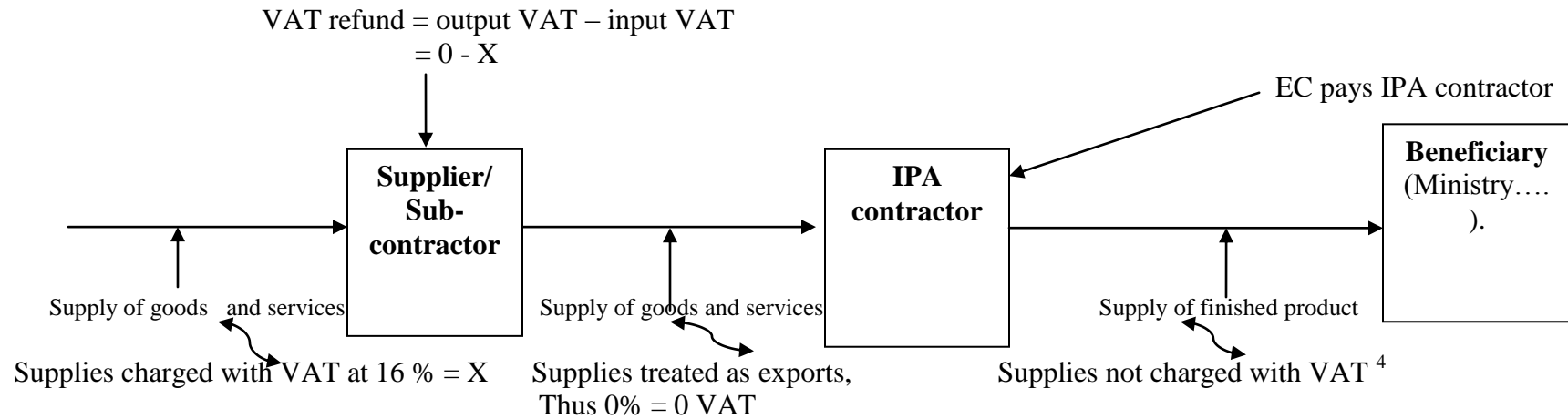
Date.....Signature.....

Office date stamp

(Name/ grade of undersigning official of ECLO Authority)

Annex 2 (1): EC- financing in respect of supplies of goods and services within the territory of Kosovo

Implementation of the procedure for excluded purchases of 20/11/2006: Supplies in the relation Beneficiary – IPA contractors under IPA agreement - article 26, could be considered as exclusions according to the current VAT legislation

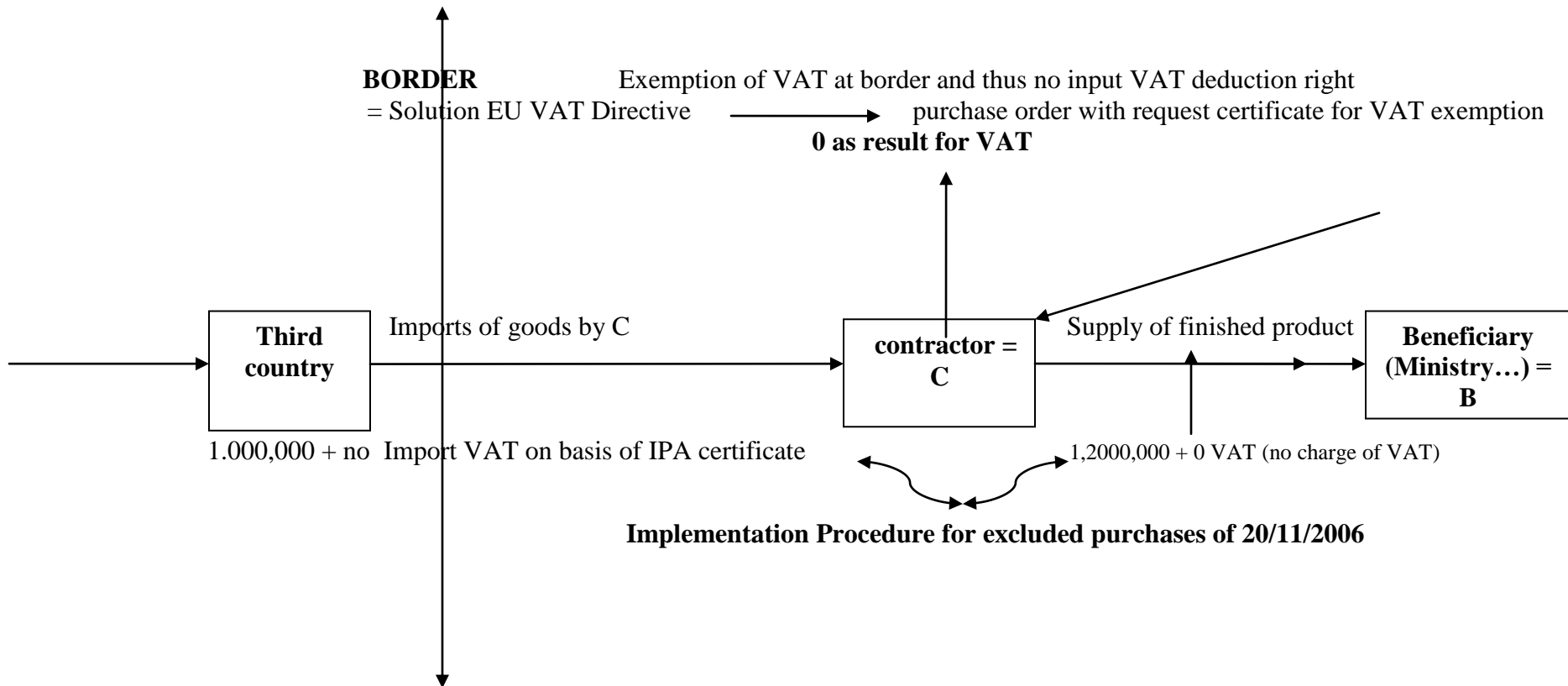


Procedure for excluded purchases of 20/11/2006

⁴ The procedure for excluded purchases of 20/11/2006 in Kosovo allows input VAT deduction. In line with the EU VAT Directive is to consider the supply of the “finished products” as supplies treated as exports – however, the VAT EU Directive only allows such supplies to be treated as exports if made to international organizations or made under diplomatic and consular arrangements. This procedure is proposed as a transitional measure in the new VAT Law which is scheduled to enter into force on January 1, 2009.

In this context, the position is defensible that the IPA contractor is contracting with the EC – this brings the procedure for excluded purchases in line with the EU VAT Directive.

Annex 2 (2): EC-financing in respect of imports of goods



**ANNEX 3:
Letterhead European Union**

PURCHASE ORDER WITH REQUEST FOR VAT EXEMPTION

To:

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.....

From:

.....
.....

Ref: Contact Name Date:

Contract No.: CRIS Nr of the contract

Subject: Purchase Order with request for VAT Exemption

Dear Sir/Madame,

The European Commission Liaison Office to Kosovo is exempt from VAT both on imports and purchases of goods and services by virtue of sub-paragraph 1.5 of article 11 of the law No. 03/L-114 of 18 December 2008 On Value Added Tax.

With our implementing partner

.....
.....
.....

The following project is currently carried out

.....
.....
....., designed to support
.....
.....

The project is funded by the European Commission Liaison Office to Kosovo. Any purchases of goods and services or imports of goods are therefore, as per the above mentioned legislation, exempted from VAT.

For the implementation of this project, our project partner has decided to buy the following goods/services from your company/which will be imported into Kosovo. **The purchase of these items will be financed from the budget of ECLO and therefore no VAT shall be charged.**

List of goods and services:

<u>No</u>	<u>Quantity</u>	<u>Unit Measure</u>	<u>Identification Nr</u>	<u>Description</u>
1.				
2.				
3.				
4.				
5.				
6.				
7.				
8.				
9.				
10.				

The person in charge for executing the purchase on behalf of our implementing partner is Mr/Mrs

.....
 address:.....
with the ID nr /passport nr.....

In accordance with the Memorandum of Understanding signed by ECLO and the Tax Administration of Kosovo, he/she is authorized to certify with his/her signature that no VAT can be charged and collected in respect of the invoice(s)

Nr(s).....

Thank you for cooperation

Yours sincerely

ECLO Team Leader's Name and Signature