# Republika e Kosovës

## Republika Kosova-Republic of Kosovo

*Qeveria-Vlada-Government*

***Ministria e Ekonomisë dhe Financave - Ministarstvo Privrede i Finansija - Ministry of Economy and Finance***

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**Administrata Tatimore e Kosoves - Poreska Administracija Kosova - Tax Administration of Kosovo**

# ADMINISTRATIVE INSTRUCTION Nr. 14 / 2010 ON IMPLEMENTATION OF LAW NUMBER 03/L-162 ON CORPORATE INCOME TAX

**Ministry of Economy and Finance**

Based on Article 39 of Law No. 03/L-162, “On Corporate Income Tax,” the Minister of the Ministry of Economy and Finance, hereby

issues:

# ADMINISTRATIVE INSTRUCTION
# No. 14 / 2010
# ON APPLICATION OF LAW NO 03/L-162, ON CORPORATE INCOME TAX

## Section 1
## Goal and Scope

The goal of this Administrative Instruction is the establishment of procedures and requirements for implementation of provisions of Law No. 03/L-162, *“On Corporate Income Tax,”* (hereafter The Law).

## Section 2
## Income from the Sale of Goods

1. Taxpayers with income from the sale of goods who maintain inventories to determine the cost of goods sold, shall use the FIFO (first-in-first-out) methodology or such other method allowed under Kosovo Accounting Standards (e.g. the weighted average cost or specific identification methods), provided that taxpayers shall not change their inventory method during a tax period.

(Comment: Kosovo Accounting Standards are moving towards being based on IFRS (International Financial Reporting Standards). As the LIFO (last-in-first-out) method is not allowed under IFRS, its use is no longer allowed for income tax purposes in Kosovo).

2. Whichever method is selected for determining the cost of goods sold, that method shall be used for the year in which it has been selected plus at least for three additional tax periods. A taxpayer who aspires to change from that method after that period of time, shall request an individual ruling from the Tax Administration of Kosovo (hereafter TAK) authorizing such change in compliance with the applicable provisions of Law No. 03/L-222 On Tax Administration and Procedures and Administrative Instructions issued thereunder.

## Section 3
## Income from Intangible Property

1. For the purposes of paragraph 1.10 of article 2 of The Law, the categories of intangible property that consist of rights only but are incorporeal, are:

1.1. patents, inventions, formulae, processes, designs, patterns, trade secrets and know-how;
1.2. copyrights including rights relating to literary, musical, or artistic compositions;
1.3. trademarks, trade names, or brand names;
1.4. franchises, licenses or contracts;
1.5. methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;
1.6. computer software; and
1.7. other similar rights.

2. In relation to computer software, licenses (as distinct from sales) of a copyright right in a computer program, leases (as distinct from sales) of copies of computer programs subject to copyright, and supplies of know-how relating to computer programs (as distinct from supplies of services for the development or modification of computer programs) shall be regarded as income from intangible property.

## Section 4
## Income from Long Term Construction

1. Paragraph 5 of article 5 of The Law provides for a departure from the normal taxable income determination rules in respect of taxpayers engaged in long-term construction contracts and projects. For the purposes of that Article, long-term construction contracts and projects are contracts and projects relating to construction work where construction extends beyond a year of income. Such contracts include those for:

1.1. construction of buildings bridges, dams, pipelines, tunnels and other civil engineering projects,

1.2. related activities such as demolition, dredging, heavy earth moving projects,

1.3. construction of major plant items including ships and transport vessels, and

1.4. similar contracts in associated fields e.g. heating and air conditioning contracts, major electrical wiring or rewiring contracts, major refurbishment of hotels, stores, etc, major construction management contracts, etc.

1.5. but do not include contracts for the sale and supply over time of what may ordinarily be regarded as the sale of trading stock e.g. it does not include installation of office furniture in a new building even where the furniture needs to be installed on delivery.

2. For corporate income tax purposes, taxpayers engaged in long-term construction contracts and projects are categorized into three broad categories as follows:

2.1. “constructors” - those who perform the construction work (either directly or through subcontractors) who are paid by an “investor” who progressively pays for the construction work by way of some combination of advance payments, progress payments and final payments;

2.2. “investors” - those who finance the construction contract work and who pay “constructors” for that work;

2.3. “constructor/investors” - those who both finance and perform the construction contract work themselves.

3. For corporate income tax purposes:

3.1. “constructors” are required to use the “percentage of completion cost estimate” method (where 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 expenditures);

Example:

The following example illustrates the method of determining the stage of completion of a contract and the duration of the recognition of income and expenses of the contract.
A construction contractor has a fixed price of 250,000 euro to build a bridge. The initial amount of income agreed in the contract is 250,000 euro. Initial assumption of contractor for the costs of the contract is 150,000 euro. Construction of the facility will occur during 2010 and 2011.
The contractor determines the stage of completion of the contract by estimating the part of the costs that have come up for work performed until now, keeping the most recent total cost of the contract. A summary of financial data during the construction period is as follows:

| | 2010 | 2011 |
|---|---|---|
| Initial amount of agreed income of the contract | 250, 000 | 250, 000 |
| Expenses incurred up to date | 90,000 | 150,000 |
| Contract costs to complete the work | 60,000 | |
| Total estimated costs of contract | 150,000 | 150,000 |
| Estimated profit | 100,000 | 100,000 |
| Stage of completion (90,000/150,000) | 60% | 100% |

Amounts of income, expenses and profit recognized in income statement in two years as follows:

| Up to now | Recognized in | Recognized in last year | current year |
|---|---|---|---|
| 2010 | | | |
| Income (250,000 x 60%) | 150,000 | | 150,000 |
| Expenses (150,000 x 60%) | 90,000 | | 90,000 |
| Profit | 60,000 | | 60,000 |
| 2011 | | | |
| Income | 250, 000 | 150, 000 | 100, 000 |
| Costs | 150,000 | 90,000 | 60,000 |
| Profit | 100,000 | 60,000 | 40,000 |

3.2. **“**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. In situations where in any tax year no income has been received and no contracts have been made which would give rise to an entitlement to receive income, then no income shall be reported and no expenses shall be allowed in relation to the long-term construction contract in that tax year;

Example:

A 2-year contract with expected total contract income of 200,000 euro and total project costs of 150,000 euro. Funds received in the first year 100,000 euro Expenses incurred in the first year 50,000 euro Then the recognition of income for the first year will be as follows:

Income in the first year 100,000 euro (which represents 50% of expected total contract income) Deductible cost in the first year 75,000 euro (being 50% of expected total costs).
Gross Profit 25,000 euro.

3.3. Where upon completion of a construction contract by “investors” or “constructor/investors” 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;

3.4. The “completed contract” method (where no income or expense is reported until the year in which the long-term construction contract is completed) is not allowed to be used;

3.5. The Director-General of TAK may in future issue a public ruling allowing further methods of recording income and expenses under long-term construction contracts in addition to those outlined above;

3.6. Any taxpayer who has commenced a long-term construction contract before the date of entry into force of this Administrative Instruction which is being accounted for on a different method than allowed under this paragraph, shall change their method to that allowed under this paragraph in the tax year in which this Administrative Instruction comes into force and shall make an adjustment to their taxable income in that tax year to reflect the change in method.

4. Many long-term construction contracts and projects involve the charging of upfront “advance” contract payments which may be payable when little or no expenses may have been incurred. In such cases, the taxation of such income shall be determined according to the method the taxpayer is using to account for income from such contracts and projects. If the taxpayer is using the “income taxed as accrued” method (investors and constructor/investors), such “advance” payments will form part of taxable income when received, but if the taxpayer is using the “percentage of completion cost estimate” method (constructors), such “advance” payments will only form part of taxable income on a proportionate basis as construction proceeds.

5. It is important that receipts or percentages of completion are correctly reflected at or near the end of each tax year. A taxpayer using the “income taxed as accrued” method cannot defer assessment of contract income simply by deliberately refraining from or postponing billing until

after the end of a tax year when there was an entitlement under the contract to bill before the end of the tax year.

6. Notwithstanding the above paragraphs, if any long-term construction contract contains a provision for retention payments (where there is provision for the customer to retain a percentage of the contract price until the maintenance period specified in the contract has elapsed), such payments will not form part of taxable income until the contractor either receives them or becomes entitled to receive them from the customer. Where such retention moneys are paid to the contractor before they are actually due on condition that the contractor remedies any defects before the construction work is handed over or accepted by the customer, they shall be treated as taxable income when such moneys are received, unless they are retained in a separate account and not available for disbursement or general use by the contractor until the construction works are completed in which case the moneys will not be treated as taxable income until the contractor is entitled to withdraw or apply them.

7. Where there are barter transactions as part of a long-term construction contract, such transactions shall be recognized as income or expense at market values in accordance with Article 47 of Law No. 03/L-222 On Tax Administration and Procedures. In those situations where market values cannot be determined or reasonably estimated, the investor or constructor/investor can apply to TAK (with appropriate justifying evidence) for approval to recognize such barter transaction incomes and expenditures at the end of the construction contract.

## Section 5
## Income from Leasing

1. Paragraph 6 of article 5 of The Law requires a sub-legal act to be issued on how taxable income from financial and operating leasing shall be determined and reported.

2. A "*financial lease*" is defined in paragraph 1.27 of Article 2 of The Law as "*a lease that transfers substantially all the risks and rewards incidental to ownership of an item of property*". A finance lease must however meet at least one of the following four conditions:

2.1. the term of the lease exceeds seventy-five percent (75%) of the useful life of the leased asset;

2.2. there is a transfer of ownership of the leased asset to the lessee at the end of the lease term;

2.3. there is an option to purchase the leased asset at an "agreed price" at the end of the lease term; or

2.4. the present value of the lease payments, discounted at an appropriate discount rate, exceeds ninety percent (90%) of the fair market value of the asset.

(Comment 1: In relation to the first of these conditions, TAK will generally accept the useful life of a leased asset as being the same useful life that TAK allows for depreciation purposes under The Law. Alternatively, lessors and lessees can make an alternative assessment of an asset's useful life in any particular case based on equipment manufacturer estimates of the expected useful life of their equipment, subject to variations in maintenance and operating conditions. In either case, for example, if an asset is determined to have a useful life of 5 years, and the term of the lease is more than 45 months (75% of that useful life), the lease will be a financial lease).

(Comment 2: In relation to the last of these conditions, the present value of lease payments is the value of the payments on their payment dates discounted to reflect the time value of money. For example, it recognizes that a payment of 100 euro today is equivalent to a payment of 105 euro in a year's time if there was an annual interest/discount rate of 5%. The present value of 100 euro required to be paid in a year's time assuming a 5% interest/discount rate is 95 euro 23 cents (= 100 euro payment due in a year's time divided by 105 being 100 euro if payment was required now plus 5% interest). For a lease payment due in two year's time, the present value of that payment would be 90 euro 70 cents (= 100 euro payment due in two year's time divided by 110.25 being 100 euro if payment was required now plus 5% interest compounded for two years). Present value calculations need to be made in respect of each lease payment with the sum total of those present values compared with the an amount equal to 90% of the fair market value of the lease asset to determine whether the lease is a financial lease under this condition).

3. Financial Leases are technically treated as finance agreements where the lessee purchases the lease asset from the lessor. Such leases are generally treated for both accounting and tax purposes as the progressive sale of the lease asset from the lessor to the lessee with the lessor treated as advancing a loan to the lessee which the lessee uses to purchase the lease asset – for income tax purposes there is:

3.1. a progressive sale of the lease asset with the principal komponent of lease payments being taxable to the lessor,

3.2. a purchase of the lease asset at the beginning of the lease (with the lessee entitled to claim depreciation deductions in respect of the lease asset), and

3.3. a loan from the lessor to the lessee with the interest component of the lease payments being assessable to the lessor and deductible to the lessee. Withholding tax on the interest component of the lease is not required to be deducted by the lessee where the lessor is a financial institution authorized by the Central Bank of Kosovo.

Example:

Company A leases a new vehicle to Company B under a 4-year financial lease. Under the lease, Company B is required to pay Company A 48 monthly lease payments of 200 euro which includes an interest component of 20 euro. In the first year of the lease, the lessor will be assessed 2,400 euro (being 2,160 principal received and 240 interest received under the lease) and can claim the costs of acquiring the lease asset amortized over the life of the lease. The lessee will be able to claim depreciation on the total cost price of the vehicle from the first year of the lease and will be able to claim the interest component (but not the principal component) as tax deductions. In the later years of the lease, the lessor will continue to receive principal and interest income and the lessee will continue to be able to claim depreciation and interest expenses. At the end of the lease period, any “agreed price” option to purchase payment made by the lessee will be assessable to the lessor, and the lessee will continue to be able to claim depreciation but there will be no other tax consequences until the lessee sells or otherwise disposes of the vehicle. If however the vehicle is returned to the lessor, this will be treated for tax purposes as a “sale” of the vehicle by the lessee to the lessor with tax consequences depending on the extent to which there is a gain or loss on the "sale" of the vehicle at that time.

4. An "*Operating Lease*" is defined in paragraph 1.26 of Article 2 of The Law as "*any lease that is not a financial lease*". Operating leases resemble asset hireage agreements - the lease payments are fully deductible for the lessee and fully taxable for the lessor. Since the lessor is the owner of the asset being leased, the lessor is able to claim a depreciation deduction in accordance with the depreciation provisions of The Law.

## Section 6
## Disallowed Expenses

1.Paragraph 1 of Article 8 of The Law deals with disallowed expenses. The following expenses are disallowed as an expens:

1.1. *Cost of acquisition an improvement of land.* As a principle, land does not lose its value in time and it is notsubjec to wear. Land is easil converti intocash '*Improvement*' *n* means wotha tincreases the value of the land and itincludes drainage works, terracing, pipelining and water supply and thersimilar works which become part of the land and which increase the to otal value of the land.
1.2 .*Cost of acquisition improvemen renewal and reconstruction of assets that are capitalized, depreciated or amortized*. Such costs are recovered over time through depreciation and amortization allowances.

1.3. *Fines, penalties, costs and interes related to them.* Such expenses occur when taxpayers violate tax or other applicable rules and requirements. They are to be covered by the profit after tax.

1.4. *Income taxes*. Gross wages including personal income tax withheld from employees,constitutes an expense; thus, it is deductible. Corporate Income Tax is not a deductible item as it is computed after the deduction of all allowed expenses.

1.5. *Input VAT* is not a deductible item if it is rebated or credited from output VAT. In one particular case it is a deductible item and this is when a corporate income taxpayer, who has opted to account for income and expenses on a "real" basis, has not reached the VAT registration threshold and thus is not entitled to charge VAT on domestic supplies.

1.6. *Loss from the sale or exchange of property between related persons.* Gains from the sale or exchange of movable or immovable property between related persons will form part of the taxable income of the party making the gain while at the same time the party making the loss will not be able to claim such loss as a deductible expense.

1.7. *Pension contributions above the maximum amount allowed by Kosovo pension law.* The law covering pensions managed by the Kosovo Pensions Savings Trust allows employers to make voluntary pension contributions inrespekt of their employees up to a maximum amount of 15% of an employee's gross wage. Such contributions are deductible to the employer, but any excess over that maximum amount, is not deductible.

## Section 7
## Allowed Expenses

1. Paragraph 2 of article 9 of The Law provides for the deductibility of education expenses paid by an employer in respect of employees. Sub-paragraph 2.4 of that Article requires that the employee remain in the employment of the employer for a minimum period after the completion of the education for which the expenses were paid by the employer. For the purposes of that sub-paragraph, the minimum period shall be 24 months.

2. If an employee leaves employment before 24 months after the completion of the education for which his/her employer paid the expenses, then

2.1 if the employee has repaid the employer in full for the education expenses, the employer will be assessed for the repayment in the year in which repayment was made and no change is made to tax deductions claimed in relation to those expenses;

2.2. if the employee has repaid the employer in part for the education expenses, the employer will be assessed for the partial repayment in the year in which repayment was made and the employer's deductible expenses in the year of the employee's departure will be reduced by the balance of the amount of the education expenses previously deducted;

2.3. if the employee has not repaid the employer for the education expenses, the employer's deductible expenses in the year of the employee's departure will be reduced by the amount of the education expenses previously deducted).

3. Paragraph 6 of article 9 of The Law refers to expenses related to operating and financial leases. Such expenses shall be deductible on the basis outlined in Section 5 of this Administrative Instruction.

4. Paragraph 7 of article 9 of The Law provides that in order for expenses to be allowed as a deduction, all expenses must be fully documented with such documents available for inspection upon request from Tax Administration. The documentation requirements for allowable expenses are outlined in Section 23 of Administrative Instruction No. 15/2010 On Implementation of Law No. 03/L-222 on Tax Administration and Procedures.

## Section 8
## Allowed Deductions

1. In paragraph 1 of article 10 of The Law, the expression *'computed before the charitable contributions are deducted'* means that the 5% allowed limit will be applied on the gross profit before such an expense is deducted from adjusted gross income.

Example:

If a company has a gross profit before charitable contributions of 10,000 euro and it has made a donation to a hospital of 400 euro, the 5% allowed limit shall be applied on the 10,000 euro and not on 10,000 - 400 = 9,600 euro. In this case 400 euro is totally deductible as it is within the allowed limit of 10,000 x 5% = 500 euro.

2. As per paragraph 4 of Article 10 of The Law, taxpayers who claim a deduction in respect of charitable contributions made during the tax period shall furnish, at the time of filing the annual tax declaration and respective financial statements, receipts signed and stamped by the beneficiaries of the charitable contributions, certifying the purpose of those donations, the amounts of those donations and the times when the donations were made. A charitable contribution deduction can only be claimed by those taxpayers who pay tax on a real income basis and thus who are already required to submit an annual tax declaration. Presumptive taxpayers cannot claim for this deduction.

3. Each receipt referred to in the previous paragraph shall contain the following information:

3.1. name of the donor;
3.2. tax identification number (fiscal number) of the donor, or where the donor is an individual not required to have a fiscal number, the individual's personal identification number;
3.3. address of the donor;
3.4. donor contact person's name and telephone number;
3.5. name of the recipient;
3.6. tax identification number (fiscal number) of the recipient;
3.7. address of the recipient;
3.8. recipient contact person's name and telephone number;
3.9. amount of charitable contribution donated;
3.10. date of donacion;
3.11. a declaration by the recipient that the data on the receipt is correct and that the recipient has no direct or indirect conflict of interest with the donor.

## Section 9
## Representation Expenses

1. Article 11 of The Law provides a deduction in respect of representation expenses but limits this to 50% of the amount invoiced for business entertainment. This deduction, and its limitations, applies in respect of business entertainment expenses. Business representation expenses such as those for publicity, advertising and for promotion and representation of products with no entertainment element, other than an incidental one, will be deductible in full under the general business expenses deductibility provisions.

2. In order for any deduction for representation expenses to be allowed under Article 11 one of the following must apply:

2.1. the expenses are incurred mainly in connection with business;
2.2. the entertainment is for an existing or prospective client or supplier;
2.3. circumstances make it necessary to discuss business along with entertainment, such as a business lunch where the main purpose is business;
2.4. employees are entertained to maintain staff goodwill at events such as parties and retirement functions.

3. The deduction for entertainment expenses under Article 11 applies in respect of business entertainment. Private entertainment expenditure is not deductible e.g. restaurant lunches with friends, or where the business or professional aspect is incidental.

4. The deduction for entertainment expenses under Article 11 applies in respect of amounts invoiced. In order for a deduction to be allowed, there must be an invoice covering the entertainment expenses. Taxpayers should be able to substantiate such expense claims by being able to provide, when requested by TAK, the following details:

4.1. the date the expenses were incurred;
4.2. the names of persons entertained;

4.3. the businesses those persons represent;
4.4. the positions those persons hold in those businesses; and
4.5. the reasons for the entertainment.

5. Representation expenses under Article 11 are 50% deductible up to an amount equal to 2% of the annual gross income. The expression *'Annual Gross Income'* in that Article means all income that arose during the tax period from sources within Kosovo and it includes income from business activity, income from the use of movable, immovable or intangible property, income from interest, income from dividends, gain from the sale of securities or immovable property and any other income whether subject to income tax or not.

## Section 10
## Bad Debts

1. Sub-paragraph 1.2 of article 12 of The Law requires bad debts to be *'written off'*. In accounting terms "written off" means an adjustment has been made in the taxpayer's books to reflect the reduction in value of accounts receivable (normally by means of an account, Provision for Bad Debts). The amount included in the provision for bad debt account is based on historical data and once the provisional amount is subtracted from the accounts receivable account gives a better perspective of the income a taxpayer can expect to receive from its accounts receivable. However, for tax purposes, an expense for bad debts cannot be claimed based on the provisional account. An adjustment must be made in the taxpayer's books to reflect the actual bad debt expense based on those specific debts that meet the requirements for being expensed (namely, a debt must be six months old, there must be adequate evidence of substantial unsuccessful efforts to collect the debt, etc). There is no expectation that the taxpayer must forego any future attempts to collect the debt. As provided in paragraph 2 of Article 12 of The Law, any bad debts that are deducted as expenses and then collected later shall be included in income in the tax period in which the collection has been made.

2. In respect of sub-paragraph 1.5 of Article 12 of The Law *'adequate evidence'* can include the following:

2.1. final decision of a competent court certifying that the debt is uncollectible;

2.2. where legal action would not be cost effective, written evidence of either a decision to treat a specific debt as bad without taking legal action due to that reason or more generally an internal policy which treats certain types of debts as bad without taking legal action due to that reason, in both cases provided the Tax Administration of Kosovo is satisfied that the threshold applied in determining whether legal action is cost effective or not is reasonable in the circumstances;

2.3. where legal action would not be feasible, written evidence of either a decision to treat a specific debt as bad without taking legal action due to that reason or more generally an internal policy which treats certain types of debts as bad without taking legal action due to that reason;

2.4. official confirmation of enforced collection unsuccessful actions;

2.5. police or other law enforcement agencies certification proving that taxpayer's debtor is not traceable;

2.6. civil office certification proving that the taxpayer has died; and

2.7. any other official document supporting the creation of a bad debt provision.

## Section 11
## Payments to Related Persons

Article 14 of The Law provides that compensation, emoluments, interest, rent and other expenses paid to related persons shall be allowed as a deduction in an amount equal to the lesser of the amount paid and the respective open market value.

Example 1:

The son of the owner of a company is employed by the company as a driver and is paid 2,000 euro/month. Market value for driving services is 400 euro. This is the amount that shall be allowed as a deduction as the driver and the company are related persons.

Example 2:

Company A and B are owned by the same individual and A rents a warehouse to B for 1,000 euro/month. Market value for such a rental service is 1,800 euro. Only 1,000 euro shall be allowed as a deductible expense as A and B are related persons.

## Section 12
## Depreciation

1. The expression in paragraph 1 of article 15 of The Law *'Owned by the Taxpayer'* means that only the owner of the tangible property, who bears the risk of wear, tear or obsolescence of the asset, is entitled to deduct depreciation charges. No depreciation deduction will be allowed for the lessee of the assets unless it is stipulated in the lease agreement that a financial lease is involved and ownership rights pass over to the lessee from the lessor through periodic payments.

2. Under paragraph 2 of article 15 of The Law, expenditures on leasehold improvements will be recovered through depreciation deductions using the straight Line Method based on the life of the leasehold. In the case of open ended leaseholds the lessee shall, at the best of his or her judgment, and based on accounting rules and best practices, define the leasehold duration and use that as the denominator for computing the annual depreciation charge of the improvement.

3. Paragraph 4 of article 15 of The Law provides for depreciation using the straight line method. Given the depreciation rates for each asset category (as categorized in paragraph 3 of Article 15),

this means new Category 1 assets (5% depreciation rate) will be depreciated in equal amounts over 20 tax periods, new Category 2 assets (20% depreciation rate) will be depreciated in equal amounts over 5 tax periods, and new Category 3 assets (10% depreciation rate) will be depreciated in equal amounts over 10 tax periods.

**Example:** Suppose that Company X at the beginning of the tax period 2010 purchases a building of 1,000,000 euro, which belongs to Category 1 of depreciable assets (which allows depreciation of 5% of the value of each asset at the end of the tax period) . The straight line method works as follows:

| Tax Period | Opening Balance | Additions | Depreciation | Closing Balance |
|---|---|---|---|---|
| 2010 | | 1,000,000 | - 50,000 | 950,000 |
| 2011 | 950,000 | | 50,000 | 900,000 |
| 2012 | 900,000 | | - 50,000 | 850,000 |
| 2029 | 50,000 | | - 50,000 | 0 |

4. Paragraph 5 of Article 15 of The Law provides that assets shall first be taken into account for depreciation purposes only when they are placed into service. No depreciation deduction will be allowed if an asset is not placed into service and if it does not serve the purpose of economic activity. A full year's depreciation can be claimed in respect of assets that are placed into service during the first six months of a year, but only a half year's depreciation can be claimed in respect of assets placed into service in the last six months of a year. In both cases, a full year's depreciation can be claimed in subsequent years up to but not including the year in which the asset is sold or otherwise disposed of – in the year of sale or disposal, a gain or loss on sale may be recognized based on a comparison between the sale/disposal price and the book value of the asset at the beginning of the year of sale/disposal.

Example:

Company X buys two cars during 2010, each for 5,000 euro, but the first is purchased on 15 April 2010 and the second on 20 September 2010. Depreciation claimable in the 2010 tax period in respect of the first car shall be the full year entitlement of 1,000 euro (20%), whereas for the second car only a half year depreciation (500 euro) is claimable. Both cars will be entitled to claim a full year's depreciation from 2011 onwards (except that the second car will only get half a year depreciation in its final period of depreciation - the first half of the year 2015).

5. Paragraph 7 of article 15 of The Law provides that Category 2 and 3 assets (as categorized under paragraph 3 of Article 15) shall be individually depreciated using the straight line method when acquired after the date of entry into force of The Law. For practical reasons, this applies to assets that are acquired on or after 1 January 2010. Paragraph 8 of Article 15 provides that assets in those categories that were acquired before that date and were depreciated under the pooling method, will continue to be depreciated under that method until the value of the pool is zero.

Example:

Suppose that Company X at the beginning of tax period 2010 possesses the following assets belonging to Category 2: 10 computers - 1,000 euro each; 2 photocopiers - 4,000 euro each; 2 automobiles - 10,000 euro each. In the first half of the 2010 tax period the company buys another photocopier for 5,000 euro.

The beginning Category 2 assets, which have a pooled opening balance of 38,000 euro will be depreciated using the straight line method at the rate of 20% per year until the value of the pool reaches zero.
The photocopier purchased in 2010 for 5,000 euro will be individually depreciated using the straight line method at a rate of 20% (1,000 euro) per year.

6. Paragraphs 9 and 10 of article 15 of The Law provide special rules for new assets with a purchase price of up to 3,000 euro. Assets with a purchase price of 1,000 euro or less can be expensed in full in the tax period in which they were purchased and were put into service. Assets with a purchase price of between 1,000 and 3,000 euro shall be recorded in a new pool (rather than individually depreciated as Category 1, 2 or 3 assets) which shall be depreciated on a straight line basis using a 20% rate. As additional 1,000 to 3,000 euro priced assets are purchased, their purchase price shall be added to the value of the pool. As such assets are sold from the pool, the purchase price of the asset sold shall be reported as ordinary business income in the tax period in which the asset is sold, but the value of the pool will not be reduced as a result of the sale.

Example:

Suppose that Company X buys a computer in early 2010 for 2,000 euro and an item of plant and machinery in early 2011 for 2,400 euro. It sells the computer for 1,000 euro in 2012.

Each of these assets meets the criteria to be included in the pool authorized under paragraph 10 of Article 15. The pool account would operate as follows:

| Tax Period | Opening Balance | Additions | Reductions | Depreciation | Closing Balance |
|---|---|---|---|---|---|
| 2010 | | 2,000 | | - 400 | 1,600 |
| 2011 | 1,600 | 2,400 | | - 800 | 3,200 |
| 2012 | 3,200 | | | - 640 | 2,560 |

For the 2012 tax period, 2,000 euro (the purchase price of the computer) will be included in taxable income but no adjustment will be made to the pool account which will continue to apply with 20% depreciation applied to the opening balance of the pool plus any additions each tax period.

7. The general rule for determining the correct depreciation for tax purposes is that depreciation of assets must be based on historical cost price. However, taking into consideration the circumstances of the post-war period in Kosovo, the Director-General of the Tax Administration of Kosovo may issue a general ruling for publicly or socially owned enterprises allowing a revalued base if he or she considers an alternative approach should be applied in the circumstances.

## Section 13
## Depreciation of Livestock

1. Paragraph 3.2 of article 15 and article 16 of The Law allow a depreciation deduction in respect of livestock used for production or breeding in an economic activity. This deduction does not apply to:

1.1. livestock raised by the taxpayer – in these cases there is no depreciable basis as the cost for raising those livestock will have already been deducted
1.2. livestock acquired for resale – in these cases such livestock will be recorded as part of the inventory of the taxpayer and deductions allowed as part of the calculations of the "cost of goods sold" (i.e. deduction is allowed each year for opening inventory plus purchases less closing inventory)
1.3. livestock not acquired for resale which has a purchase cost of 1,000 euro or less – such livestock is able to be claimed as a current expense in the year of purchase under paragraph 9 of Article 15 of The Law
1.4. livestock not acquired for resale which has a purchase price of between 1,000 and 3,000 euro which has been purchased on or after 1 January 2010 – depreciation deductions for such livestock are allowable as part of the asset pool provided for under paragraph 10 of Article 15 of The Law
1.5. Given the above, the depreciation deduction allowable under paragraph 3.2 of Article 15 and under Article 16 will in practice be limited to selected high-value livestock normally those with a valued pedigree. In such cases, the depreciation deduction allowable, as with other category 2 assets, is 20% of the purchase price per year on a straight-line basis.

## Section 14
## Special Allowance for New Assets

Paragraph 1 of Article 17 of The Law provides that plant and machinery, railway inventory and locomotives used for railway transportation, airplanes, ships, heavy transport vehicles, earth moving equipment, bulldozers, scrapers and other heavy vehicles purchased new locally or imported for the first time in Kosovo between January 1, 2010 and December 31, 2012, will benefit from a special allowance of 10% in addition to the normal allowable depreciation deductions.

Example:

Suppose that Company X has an opening balance of Category 3 for the tax period 2010 of 160,000 euro. During the first half of the year company imports from Germany a new heavy transport vehicle of 40,000 euro. Depreciation deduction for this tax period will have three components:

1. Depreciation of the new vehicle as an individual asset: 40,000 x 10% = 4,000 euro;

2. Depreciation of the pool of Category 3 assets on hand at the beginning of the 2010 tax period: 160,000 x 15% = 24,000 euro;

3. Special allowance for the new vehicle: 40,000 x 10% = 4,000 euro.

Total depreciation deduction 32,000 euro. The special allowance for the new vehicle is granted only once, in the tax period in which the asset is purchased in or brought into Kosovo.

## Section 15
## Repairs and Improvements

1. Article 18 of The Law deals with repairs and improvements. The term *‘repairs or improvements’* means work that is done to substantially increase the capacity, life, conditions and productivity of the asset. In the case of a building, roofing, plumbing, plastering and other similar work are considered repairs and improvements, but painting is not. In the case of a truck, changing tires is not an improvement but, replacing the existing engine with a new one, is a repair and improvement.

2. Paragraph 1 of Article 18 of The Law provides that amounts expended for repairs or improvements to an asset shall be capitalized and added to the depreciable cost base of the asset if the repairs or improvements extend the useful life of the asset for at least one year and the amount of repair or improvement is greater than 1,000 euro. In those situations where the repairs or improvements extend the use of the asset by one year or more, and the amount expended on repairs or improvements is greater than 1,000 euro, the full amount expended is required to be capitalized (1,000 euro of that amount is not allowed to be claimed as an expense). Conversely, in those situations where the repairs or improvements do not extend the useful life of the asset, or extend it for less than a year, the amounts involved may be expensed in full even where the amounts exceed 1,000 euro.

3. Paragraph 2 of Article 18 of The Law provides the rules for calculating depreciation where amounts expended for repairs or improvements to an asset are capitalized.

3.1. For repairs made to Category 1 assets whenever acquired, and for repairs made to Category 2 and Category 3 assets acquired on or after the entry into force of The Law, the capitalized amounts of repair are added to the remaining book value of the asset.

Example:

Suppose that the opening book value of a taxpayer's building is 100,000 euro. During the 2010 tax year the taxpayer spends 4,000 euro on repairs to the roof which extend the useful life of the building for five more years. Depreciation on the building for the 2010 tax year is calculated as follows:

Opening book value of the building 100,000 euro Capitalized repairs and improvements 4,000

Closing book value before depreciation 104,000 Depreciation 5% 5,200 Closing book value of the building 98,800

3.2. For repairs made to Category 2 and Category 3 assets acquired before the entry into force of The Law, the capitalized amounts of repair are:

3.2.1. where the amount of the repair is between 1,000 and 3,000 euro, added to the pool referred to in paragraph 10 of Article 15 of The Law as a new qualifying asset;

3.2.2. where the amount of the repair is over 3,000 euro, treated as a new Category 2 or Category 3 asset, as applicable, for which depreciation will be allowed as a deduction in accordance with paragraph 4 of Article 15 of The Law.

## Section 16
## Exploration and Development Costs

1. Paragraph 1 of Article 20 of The Law provides for the amortization of a natural deposit of minerals and other natural resources. The user of the deposit can claim a deduction for the exploration and development costs. Exploration costs, development costs and related interest must be added to a capital account as they are incurred. At the end of the tax period, the portion of exploration and development costs pertaining to that period shall be determined by multiplying the balance in the capital account by a coefficient of amortization (CA) which is:

$$CA = \frac{\text{Number of units extracted during the year}}{\text{Total estimated units in the deposit}}$$

Example:

Company X has taken on a lease on a copper field and the estimated number of units in the natural deposit is 15,000,000. The production for the year is 1,500,000 units. The balance of exploration costs, development costs and related interest in the capital account at the end of the tax period is € 500,000. To determine the amount of amortization allowed for the tax period, the balance in the account must be multiplied by the CA. In this case, the coefficient is 10%, (1,500,000/15,000,000). The amortization allowed as a deduction, therefore is € 50,000.

2. To determine the total estimated number of units in the deposit, the taxpayer must obtain a report from experts and must make it available to Tax Administration for inspection upon request or submitted with the annual tax declaration. The computation of the units of extraction must be done using generally accepted methods. Tax Administration reserves the right to use the services of independent specialists to review the engineering reports and the extraction computation methods.

## Section 17
## Capital Gain or Loss

1. Paragraph 4 of Article 21 of The Law requires the use of open market values where sales of capital assets are made between related persons for sales prices that are less than open market value. In such cases, the open market value shall be determined as:

1.1.The estimated monetary amount for a sale of the same asset between a willing buyer and a willing seller in an arm's-length transaction

1.2.Or, where the above is not available, the amount that would arise from the sale of a similar asset in similar circumstances (e.g. similar quality, similar size or time period and similar conditions of sale)

1.3.Or, where neither of the above apply, a method approved by TAK which provides a sufficiently objective approximation.

1.4.The method allowable by TAK under the last of the above options is a cost plus basis, with cost being labor and material costs plus a percentage of overheads and then a reasonable mark up percentage. Taxpayers wishing to use this method need to provide TAK with documentation showing why they could not use the two previous options.

2. Paragraph 13 of Article 21 of The Law covers sales of capital assets involving installment agreements which span more than one tax period. In such cases, capital gains or losses shall be reported on a straight-line basis over the life of the installment arrangement, starting from the earlier of the date of payment of a deposit or the date such deposit was due and ending with the earlier of the date of payment of the last installment payment or the date such payment was due.

3. In making these straight-line basis calculations:

3.1. where the start date for the installment arrangement falls within the first 6 months of a year, the start date of the installment arrangement shall be regarded as being the first day of that year;
3.2. where the start date of the installment arrangement falls within the second 6 months of a year, the start date shall be regarded as being the first day of that 6 months period;
3.3. where the end date of the installment arrangement falls within the first 6 months of a year, the end date shall be regarded as being the last day of that 6 months period;
3.4. where the end date of the installment arrangement falls within the second 6 months of a year, the end date of the installment arrangement shall be regarded as being the last day of that year;
3.5. any installment payments to the extent the amount of the payment is not certain until a specific event occurs (e.g. where part of the sale/purchase price is contingent on achieving a certain level of sales or another event, where there is a possibility that that achievement or event will not happen) should be ignored – the recognition of the uncertain income for the seller and uncertain cost for the buyer in these circumstances will only arise if and when the contingency is removed and the amount of the payment becomes certain.

Example 1:

If a capital asset has a net value (cost of acquisition plus cost of improvements less depreciation claimed for tax purposes) in the books of 5,000 euro and is sold for 7,000 euro, this results in a capital gain of 2,000 euro. If the sale agreement envisages installment payments being made over the period from 1 April 2010 until 31 March 2012 (a two year period spanning three tax years), then the capital gain will be recognized as follows:

In making straight-line basis calculations, the installment arrangement will be treated as starting on 1 January 2010 and ending on 30 June 2012, a period of 30 months
The amount of the gain recorded in respect of 2010 will be 2,000 x 12/30 = 800 euro
The amount of the gain recorded in respect of 2011 will be 2,000 x 12/30 = 800 euro
The amount of the gain recorded in respect of 2012 will be 2,000 x 6/30 = 400 euro.

Example 2:

If a capital asset has a net value in the books of 9,000 euro and is sold for 6,000 euro, this results in a capital loss of 3,000 euro. If the sale agreement envisages installment payments being made over the period from 1 October 2010 until 30 September 2012, then the capital loss will be recognized as follows:

in making straight-line basis calculations, the installment arrangement will be treated as starting on 1 July 2010 and ending on 31 December 2012, a period of 30 months
the amount of the loss recorded in respect of 2010 will be 3,000 x 6/30 = 600 euro

the amount of the loss recorded in respect of 2011 will be 3,000 x 12/30 = 1,200 euro
the amount of the loss recorded in respect of 2012 will be 3,000 x 12/30 = 1,200 euro

## Section 18
## Tax Losses

1. Paragraph 5 of Article 23 of The Law provides that tax losses incurred in one tax year shall generally only be able to be carried forward and offset against taxable income in subsequent years of the same business that incurred the loss. That paragraph also provides that carry forward of losses will not be allowed where the business changes its type of business organization (e.g. a business changes from being run as a personal business enterprise to being run under a partnership or an incorporated legal entity) or has an ownership change of more than 50%.

1.1 relation to changes of business organization, an exception to the general rule that tax losses will no longer be able to be carried forward applies where another taxpayer “acquires” the taxpayer pursuant to a TAK approved “reorganization” under Article 26 of The Law in which case, tax losses incurred by the taxpayer prior to reorganization may be claimed by the acquiring taxpayer in subsequent years.

1.2. In relation to ownership changes, in order for tax losses to be carried forward, throughout the period commencing with the first day of the tax loss year to the last day of the tax year in which the loss is to be offset, the following must have applied:

1.2.1. for partnerships or similar joint arrangements, at least 50% of the partners have to be the same

1.2.2. corporated or similar entities, at least 50% of the shares, at least 50% of the voting rights, at least 50% of the entitlement to dividends and at least 50% of the rights to capital distributions have to be held by the same persons.

Example 1:

A partnership is run by 3 partners (A, B and C), each of whom have equal shares in the partnership. It makes a tax loss of 10,000 euro in 2010. During 2011, C leaves and is replaced by new partner D. The 2010 tax loss is able to be carried forward to 2011 as there is 2/3 common ownership (A and B). During 2012, B leaves and is also replaced by new partner E. The 2010 tax loss is not able to be carried forward to 2012 (as there is now only a 1/3 common ownership, A). Any tax loss incurred in 2011 will however be able to be carried forward as there is a 2/3 common ownership between 2011 and 2012 (A and D)

Example 2:

A company has 1,000 shares (all of which have equal rights) and which are held as follows:

-Shareholder A 400 shares

-Shareholder B 300 shares

-Shareholder C 150 shares

-Shareholder D 150 shares

In a subsequent year, the shareholding has changed to:

-Shareholder A 300 shares

-Shareholder B 0 shares

-Shareholder C 150 shares

-Shareholder D 0 shares

-Shareholder E 550 shares

A tax loss from the first year cannot be carried forward to the subsequent year as between them Shareholders A and C have retained only 450 shares (less than 50% of the total)

## Section 19
## Reorganization

1. Paragraph 3 of Article 26 of The Law provides that distributions to shareholders in respect of their equity interest under a reorganization will not constitute taxable income of the shareholder. In the case of a qualified reorganization of a SOE, distributions to which that paragraph applies shall include shares of the proceeds from the sale of shares of subsidiary corporations of a SOE that is privatized to persons in their capacity as co-owners or co-managers of the SOE, but shall not include severance payments made to persons in their capacity as employees or former employees of the SOE (which shall constitute taxable income of those persons for the purposes of Law No. 03/L-161 On Personal Income Tax).

2. Paragraph 4 of Article 26 of The Law provides that in the case of reorganizations of a taxpayer that in general acquiring taxpayers shall succeed to and take the place of acquired taxpayers with respect to inventories, loss carry forwards, dividend accounts, and all other such items except where otherwise established in a sub-legal act issued by the Minister of Economy and Finance. The remaining paragraphs of this section cover such exceptions.

3. For the purposes of this Section:

3.1. *‘Disqualified reorganization’* means any reorganization that has not been granted approval from the Tax Administration of Kosovo. Such a disqualified reorganization shall be treated as anormal sale of entity or its assets;

3.2. *‘NewCo’* means a subsidiary corporation of an enterprise established pursuant to Article 8 of Law No. 03/L-067 On the Privatization Agency of Kosovo;

3.3. *'PAK'* means the Privatization Agency of Kosovo established under Article 1 of Law No. 03/L-067 On the Privatization Agency of Kosovo;

3.4. *'POE'* means a Publicly-owned Enterprise as defined in Article 3 of Law No. 03/L-067 On the Privatization Agency of Kosovo;

3.5. *‘Qualified reorganization’* means a reorganization of a SOE included in the process of privatization according to the rules stipulated by PAK or a reorganization of a POE, pursuant to a written plan of reorganization for business, economic and financial purposes and which does not have as itspurpose avoidance of tax by any parties or shareholders. A qualified reorganization is approved in writing by the Tax Administration of Kosovo;

3.6. *‘Reorganization’* includes the following:

3.6.1. A change in the form of an entity, or in its name or place of organization;

3.6.2. A recapitalization of an entity;

3.6.3. A combination of two or more entities into one, whether by fusion, absorption, or otherwise;

3.6.4. A division of an entity into two or more entities, whether by split up, split off, spin off or otherwise that (immediately after the division) are under the control of the divided entity, its shareholders or both;

3.6.5. The acquisition of control of an entity in exchange solely for voting interest in the acquiring entity;

3.6.6. The acquisition of substantially all assets of an entity in exchange solely for voting interest in the acquiring entity; and

3.6.7. The transfer of some or all of the assets of a SOE to one or more NewCos pursuant to Article 8 of Law No. 03/L-067 On the Privatization Agency of Kosovo;

3.7. *‘SOE’* means a Socially-owned Enterprise as defined in Article 3 of Law No. 03/L-067 On the Privatization Agency of Kosovo.

4. In the case of a qualified reorganization of a SOE, where the SOE (or PAK on its behalf) establishes one or more NewCos, the tax position of the SOE is not transferred to the NewCo(s) but remains with the SOE. For the purpose of this paragraph, ‘tax position’ means any tax due, any tax loss or any tax credit for each of the applicable taxes in Kosovo but without prejudice to the right of the PAK to assign responsibility to the NewCo(s) for settlement of such tax liabilities as may be agreed from time to time between the PAK and the Ministry of Economy and Finance or as may be determined by applicable law.

Example:

A SOE operating a manufacturing business has building and manufacturing plant assets. It has been operating at a loss and has income tax losses to carry forward of 100,000 euro and unpaid VAT of 50,000 euro relating to the last two years. The Privatization Agency of Kosovo decides to privatize this business and a NewCo is established for this purpose. An agreement between the Privatization Agency and MEF provides that unpaid tax debts of the last 12 months of VAT owing (assumed to

be 40,000 out of the 50,000 euro VAT owing in this example) will be carried forward from the SOE to the NewCo.
The assets of the SOE will be transferred to the NewCo (at the same book value they previously had in the financial accounts of the SOE) which will also be responsible for meeting the unpaid VAT of 40,000 euro (along with other current trading liabilities) from the SOE. The SOE in this case will remain with no assets and will remain with unpaid VAT due of 10,000 euro and with income tax losses of 100,000 able to be carried forward but likely to be unused.

5. A SOE (or PAK on its behalf) or a POE which is reorganized shall seek written approval from the Tax Administration of Kosovo that the reorganization is a qualified reorganization. Each SOE or POE applying for a qualified reorganization status shall submit a written request to the Tax Administration explaining the reasons why the reorganization is taking place, outlining the reorganization mechanism and summarizing the assets and liabilities (if any) to be transferred. The Tax Administration before granting the approval reserves the right to audit the books and records of the SOE or POE.

## Section 20
## Transfer Prices

1. Paragraph 4 of Article 27 of The Law provides for differences between “open market value” and “transfer prices” to be included in taxable income. This provision only applies where there are asset transactions or contract obligations between related persons. In broad terms, the intention of this provision is to ensure that prices in relation to transactions or obligations between related persons (transfer prices) reflect arm's length prices (represented by open market value) – if, for example, goods sold and/or overhead costs charged to a Kosovo branch of a taxpayer by its head office based outside Kosovo are regarded as being at the same level that would be charged by a non-related party providing similar goods or services, then there would be no difference between the price charged and the arm's length price and no taxable income would arise. Conversely, if the costs charged by the head office were regarded as exceeding those that would be charged by a non-related party providing similar goods or services (thereby reducing the taxable income of the Kosovo branch), the difference would be added back as taxable income of the Kosovo branch.

2. In determining any differences between “open market value” and “transfer prices”, the “transfer price” is, in accordance with paragraph 1 of Article 27 of The Law, the actual price charged or chargeable between the related parties. Determination of the “open market value” is however more complex with the method to be used in its determination being subject to the extent to which information is available about non-related parties providing similar goods or services. The method to be used in determining “open market value” is outlined in the following paragraphs.

3. In accordance with paragraph 3 of Article 27 of The Law, “open market value” shall, if possible, be determined by the comparable Uncontrolled Price Method. This method can be used where the taxpayer buys or sells the particular good or service, in similar quantities and under similar terms to non-related parties in similar markets (an internal comparable) or a non-related party buys or sells the particular good or service, in similar quantities and under similar terms to another non-related party in similar markets (an external comparable). Transactions may serve as comparables despite the existence of differences between those transactions and related party transactions where the differences can be measured on a reasonable basis and appropriate adjustments can be made to

eliminate the effects of those differences. Comparables, or adjusted comparables where differences are eliminated, will be the “open market value”.

Example 1:

A taxpayer sells 1,000 tons of a product for 80 euro per ton to an associated enterprise in its corporate group, and at the same time sells 500 tons of the same product for 100 euro per ton to an independent enterprise. This case requires an evaluation of whether the different volumes should result in an adjustment of the transfer price. The relevant market should be researched by analysing transactions in similar products to determine typical volume discounts.

Example 2:

An illustrative case where adjustments may be required is where the circumstances surrounding controlled and uncontrolled sales are identical, except for the fact that the controlled sales price is a delivered price and the uncontrolled sales are made from the factory excluding the costs of transportation and insurance. The differences in terms of transportation and insurance generally have a definite and reasonably ascertainable effect on price. Therefore, to determine the uncontrolled sales price, adjustment should be made to the price for the difference in delivery terms.

4. Where there is an absence of comparable or adjusted comparable data such that the comparable uncontrolled method cannot be used, “open market value” shall be determined using the resale price method (which is more suited for use by distributors) or the cost plus method (which is more suited for use by manufacturers) as outlined in the following paragraphs.

5. The Resale Price method is usable where goods or services purchased by a taxpayer from a related party are resold to an unrelated party, particularly where the taxpayer seller adds relatively little value to the goods or services. In such cases, the open market value is calculated by deducting from the resale price an appropriate resale gross margin which allows the seller to recover its operating costs and to earn an arm's-length profit based on the functions performed, assets used, and the risks assumed. This gross margin can be determined by reference to the resale price margin earned by a member of the same group as the taxpayer in comparable uncontrolled transactions (internal comparable) or the resale price margin earned by a non-related party in comparable uncontrolled transactions (external comparable).

Example 1:

Assume that there are two distributors selling the same product in the same market under the same brand name. Distributor A offers a warranty; Distributor B offers none. Distributor A is including the warranty as part its pricing strategy and so sells its product at a higher price resulting in a higher gross profit margin (if the costs of servicing the warranty are not taken into account) than that of Distributor B, which sells at a lower price. The two margins are not comparable until an adjustment is made to account for that difference.

Example 2:

A company sells a product through independent distributors in five countries in which it has no subsidiaries. The distributors simply market the product and do not perform any additional work. In one country, the company has set up a subsidiary. Because this particular market is of strategic importance, the company requires its subsidiary to sell only its product and to perform technical applications for the customers. Even if all other facts and circumstances are similar, if the margins are derived from independent enterprises that do not have exclusive sales arrangements or perform technical applications like those undertaken by the subsidiary, it is necessary to consider whether any adjustments must be made to achieve comparability.

6. The Cost Plus Method is usable where costs are incurred by a taxpayer in the supply of a good or service to a related party. In such cases, the open market value is determined by adding to the costs incurred by the taxpayer (calculated in accordance with accounting principles that are generally accepted for the particular industry) a comparable gross mark-up which is determined by reference to the cost plus mark-up earned by a member of the same group as the taxpayer in comparable uncontrolled transactions (internal comparable) or the cost plus mark-up earned by a non-related party in comparable uncontrolled transactions (external comparable). In either case, the returns used to determine an arm's length mark-up must be those earned by persons performing similar functions and preferably selling similar goods to non-related parties. Where the transactions are not comparable in all ways and the differences have a material effect on price, taxpayers must make adjustments to eliminate the effect of such differences (such as differences in the relative efficiency of the supplier, and any advantage that the activity creates for a group that includes the taxpayer).

Example 1:

A is a domestic manufacturer of timing mechanisms for mass-market clocks. A sells this product to its foreign subsidiary B. A earns a 5 percent gross profit mark up with respect to its manufacturing operation. X, Y, and Z are unrelated domestic manufacturers of timing mechanisms for mass-market watches. X, Y, and Z sell to unrelated foreign purchasers. X, Y, and Z earn gross profit mark ups with respect to their manufacturing operations that range from 3to 5 percent. A accounts for supervisory, general, and administrative costs as operating expenses, and thus these costs are not reflected in cost of goods sold. The gross profit mark ups of X, Y, and Z, however, reflect supervisory, general, and administrative costs as part of costs of goods sold. Therefore, the gross profit mark ups of X, Y, and Z must be adjusted to provide accounting consistency.

Example 2:

Company C in country D is a 100% subsidiary of company E, located in country F. In comparison with country F, wages are very low in country D. At the expense and risk of company E, television sets are assembled by company C. All the necessary components, know-how, etc. are provided by company E. The purchase of the assembled product is guaranteed by company E in case the television sets fail to meet a certain quality standard. After the quality check the television sets are brought -- at the expense and risk of company E -- todistribution centers company E has in several countries. The function of company C can be described as a purely contract manufacturing function. The risks company C could bear are eventual differences in the agreed quality and quantity. The basis for applying the cost plus method will be formed by all the costs connected to the assembling activities.

Example 3:

Company A of a corporate group agrees with company B of the same group to carry out contract research for company B. All risks of a failure of the research are borne by company B. This company also owns all the intangibles developed through the research and therefore has also the profit chances resulting from the research. This is a typical setup for applying a cost plus method. All costs for the research, which the related parties have agreed upon, have to be compensated. The additional cost plus may reflect how innovative and complex the research carried out is.

7. Where a taxpayer believes that the above methods cannot be used, and can provide evidence of this, the Tax Administration of Kosovo may allow use of the profit split method. The profit split method may be applied where the operations of two or more related parties are highly integrated making it difficult to evaluate their transactions on an individual basis and/or where the existence of valuable and unique intangibles makes it impossible to establish the proper level of comparability with uncontrolled transactions under another method.

7.1. The first step under this method is to determine the total profit earned by the parties from a controlled transaction. The profit split method allocates the total integrated profits related to a controlled transaction, not the total profits of the group as a whole. The profit to be split is the operating profit before the deduction of interest and taxes.

7.2. The second step is to split the profit between the parties based on the relative value of their contributions to the related party transactions, considering the functions performed, the assets used, and the risks assumed by each related party, in relation to what non-related parties would have received, with the result being the open market value.

8. In the event that none of the previous methods can be applied, the Tax Administration of Kosovo may allow use of the transactional net margin method. This method compares the net profit margin of a taxpayer arising from a related party transaction with the net profit margins realized by non-related parties from similar transactions and examines the net profit margin relative to an appropriate base such as costs, sales or assets, taking into account the nature of the business activity, with the result being the open market value.

9. Taxpayers who conduct transactions with related parties must maintain sufficient documentation to justify their choice of open market value determination method and to show that it produces an “arm's length” result.

## Section 21
## Commercial Income of NGOs

1. Paragraph 1 of Article 33 of The Law deals with commercial income of NGOs. The expression *‘commercial or other activity that is not exclusively related to its public purpose’* shall include the following meanings:

1.1. in the case of a church that sells candles and uses the proceeds from the sale for the improvement of the premises to better serve the community, such a commercial activity shall be deemed to be exclusively related to the public benefit purpose.

1.2. in the case of an NGO operating in the promotion of agricultural activities, the sale of seeds and seedlings shall be deemed to be exclusively related to its primary beneficial activity provided that NGO uses the proceeds of the sale within the scope of the public benefit purpose.

1.3. in the case of an NGO operating in the health area which runs a retail kiosk, such commercial activity shall not be deemed as exclusively related to its primary public benefit purpose. In this case the income derived from the retail kiosk shall be subject to corporate income tax, reduced by any deductions directly related to the retail kiosk which are allowed under The Law.

2. Paragraph 2 of Article 33 of The Law gives TAK the right to treat *'excessive profits'* made by NGOs as income subject to corporate income tax. NGOs with public benefit status are supported by donors who receive deductions from their gross income in order to encourage private contributions toward meeting the social needs of society. Under such circumstances, an NGO should be expected to operate on a lesser margin than a private business providing the same or similar service. Indeed, Article 17.2 of Law No. 03/L-134 On Freedom of Association in Non-Governmental Organizations provides that NGOs shall receive public benefit status only if significant benefits are provided free of charge or at less than fair market value to disadvantaged individuals or groups. At the same time, it is recognized that an NGO with public benefit status is entitled to making such a profit as is necessary to sustain itself and possibly provide for growth and expansion of services. To the extent that profits of NGOs exceed those needed for this purpose, they will be considered to be 'excessive profits'.

3. More specifically, pursuant to paragraph 4 of Article 33 of The Law, the following situations could be treated as giving rise to *'excessive profits'*:

3.1. where profits derived from NGO activities related to its public purpose are reduced by payments to NGO managers, officials, employees or members of amounts which are in excess of that that would ordinarily be paid to such persons taking into account their responsibilities and the duties they have performed in relation to those activities;

3.2. in the case of NGOs which provide goods or services, where profits derived from NGO activities related to its public purpose are made by charging prices which are in excess of those that would ordinarily be charged taking into account the quantity and quality of the goods or services and the terms on which they are provided;

3.3. in the case of NGOs which rent out property, where profits derived from NGO activities related to its public purpose are made by charging rent at rates which are in excess of those that would ordinarily be payable taking into account the standard and location of the property and the term and other conditions of the rental agreement;

3.4. in the case of NGOs which have money to lend, such as micro-finance institutions, where profits derived from NGO activities related to its public purpose are made by charging interest at rates which are in excess of that that would ordinarily be paid taking into account the risk, term and other conditions of the loan.

3.5. In each case, the 'excessive profit' that would be subject to corporate income tax is the amount of the excess profit made above that that would be ordinarily made (rather than the fulamount of the profit).

4. For the purposes of determining the extent to which any *'excessive profits*' have been earned by an NGO under paragraph 2 of this Section, TAK shall be able to obtain information in relation to that NGO from:

4.1. an audit of the NGO (as authorized by paragraph 2 of Article 33 of The Law);

4.2. the annual reports of the NGO that have filed pursuant to Article 18 of Law No. 03/L-134 On Freedom of Association in Non-Governmental Organizations with the competent body under that law;

4.3. any third party or other source that TAK has information access to under the law.

## Section 22
## Tax Declarations

1. In accordance with paragraph 1 of Article 34 of The Law corporate income tax declarations and financial statements shall be submitted to the Tax Administration of Kosovo on or before the 31st day of March of the year following the tax period. Such declarations/financial statements may be submitted to TAK via an authorized bank or financial institution. The tax declaration shall be considered as an assessment made by taxpayers themselves.

2. Where the filing and payment due date for any tax declarations or information statements is a Saturday, Sunday or National Holiday, such forms may be submitted, without penalty for late filing or late payment (including interest), at the latest on the first working day following the Saturday, Sunday or National Holiday.

3. For income tax purposes, partnerships are required to file annual partnership income and expense declarations (they are not required to file corporate income tax declarations) which show the share of profits or losses of the partnership that are allocated to the partners, but are not required to make any payment of related tax liability. The partners themselves have to account for payment of tax in respect of any income they receive from partnerships. Incorporated partners of partnerships who are required to file corporate income tax declarations and who receive profit shares from partnerships must include them with other income liable for corporate income tax.

**Section 23**
**Books and Records**

1. Taxpayers with annual gross income of 50,000 euro or more and those with annual gross income of less than 50,000 euro who opt to be taxed on a real income basis shall keep books and records in accordance with the requirements of:

   1.1. Article 36 of The Law; and
   1.2. Paragraph 4 of Section 17 of Administrative Instruction No. 15 /2010 On Implementation of Law No. 03/L-222 on Tax Administration and Procedures.

2. Taxpayers with annual gross income of less than 50,000 euro who have not opted to be taxed on a real income basis shall keep books and records in accordance with the requirements of:
   2.1. Article 37 of The Law; and
   2.2. Paragraph 2 of Section 17 of Administrative Instruction No. 15/2010 On Implementation of Law No. 03/L-222 on Tax Administration and Procedures.

3. Taxpayers specified in paragraphs 1 and 2 of this Section are required to issue invoices/receipts for the supply of goods and services made by them.

4. The content of the books and records referred to in paragraphs 1 and 2 of this Section and of the invoices/receipts referred to in paragraph 3 of this Section shall be in accordance with Administrative Instruction No. 15/2010 On Implementation of Law No. 03/L-222 on Tax Administration and Procedures.

5. The following provisions of Law No. 03/L-222 on Tax Administration and Procedures apply in respect of the books and records referred to in this Section:

5.1. Article 13, in relation to translation, retention and storage of records and the periods to which records should relate;

5.2. Article 14, in relation to access to records by TAK and to removal and copying of such records;
5.3. Articles 14 and 15, in relation to the requirements for taxpayers to produce records when requested by TAK;
5.4. Article 19, in relation to records that are lost or destroyed;

5.5. Articles 15 and 53, in relation to penalties for not keeping records or for not allowing TAK access to records.

## Section 24
## Entry into force

The present Administrative Instruction shall enter into force upon signing by the Minister of Economy and Finance.

**Ahmet SHALA**

**Minister of Economy and Finance**

**Date 19 / 11 / 2010**