Welcome to the seminar organized by the Tax Administration of Kosovo

September, 2019

Administrata Tatimore e Kosovës
Poreska Administracija Kosova
Tax Administration of Kosovo

Topics:

1. Tax treatment of long-term construction contracts

2. Amendments to the Corporate Income Tax Law

Sami Salihu – acting Director of Taxpayer Service and Education Department

Purpose

Clarification of tax liabilities, namely the manner of declaration and payment of Value Added Tax and Personal Income Tax, respectively Corporate Income Tax, for persons engaged in long-term construction projects and contracts.

Long-term contract

- Long-term construction projects and contracts are those that have longer span than a tax period.
- Incomes from long-term construction contracts include: income from construction of buildings, bridges, dams, pipelines, tunnels, etc.
- Long-term contracts are not considered as commercial stock sales contracts, as it is the case with the furnishing of offices in the new building and in cases where the furniture must be assembled during delivery.

Persons engaged in long-term construction contracts activity

- Contractor (executor of works)
- Investor
- Investor-Contractor.

Definitions

- Long-term construction projects and contracts – projects and construction contracts that extend to two or more tax periods;
- Contractor (executor of works) – the person performing the construction work, either directly or through subcontractors, who is paid by the investor paying progressively for the construction work, through combination of advance payments, progress payments and final payments.
- Investor – the person who finances construction contract works and pays the contractor for the work performed.
- Investor-Contractor - the person who finances and performs the construction work.
- Barter transaction – a transaction involving two parties, where one party provides the other party with the goods, services or assets other than cash, in exchange for the goods, services or assets other than cash;

Income from construction activity

Persons engaged in long-term construction projects and contracts shall report taxable income from those long-term projects and contracts, avoiding the common rules of determining taxable income.

Determining the income of the "contractor"

- Contractors are required to use the "percentage of completion" method to determine gross income for the period.

- The “percentage of completion” method is based on the proportion between the costs incurred during the tax period, compared to the projected total project costs.

Example:

Company "X" (contractor), has contracted works for the construction of a bridge in the amount of €250,000, for the construction of which the company plans to incur costs in the amount of €150,000. Construction of the bridge will occur during the period 2017 and 2018, and costs incurred in 2017 are €90,000, while in 2018 are €60,000.

Recognition of income by periods, is as follows:

Description	2017	2018
Initial amount of income agreed in the contract	250,000	250,000
Incurred costs to date	90,000	150,000
Contract costs for completing the work	60,000	
Estimated total contract costs	150,000	150,000
Estimated profit	100,000	100,000
Percentage of completion (90,000/150,000)	60%	100%

The amounts of income, cost and profit recognized in the income statement during the two years, are as follows:

Description	To date	Recognized during the previous year	Recognized during this year
Year 2017			
Incomes (250,000 x 60%)	150,000		150,000
Incurred costs (150,000 x 60%)	90,000		90,000
Gross profit	60,000		60,000
Year 2018			
Incomes	250,000	150,000	100,000
Incurred costs	150,000	90,000	60,000
Gross profit	100,000	60,000	40,000

Determining the income of the "Investor" and "Investor-Contractor"

Investor and Investor-Contractor are required to use the following methods to determine the gross income of the period:

a. If advance payments have been received during the tax period, the recognition of income will be based on the receipt of advance payments.

b. If during the tax period there is a right to receive advance payments under contract, but no funds have been collected, recognition of income will be based on this right.

c. If during the tax period there are sales contracts, but no income has been received as advance payment or there is no right to receive advance payments based on the contract, then the recognition of income will be based on the accrual principle.

d. If none of the above criteria are met during the tax period, then there are no incomes to be reported, and such investments are treated as ongoing investments.

Determining the cost of the “Investor” and “Investor-Contractor”

Regarding the sub-section of point c), the income shall be recognized on an accrual basis in three cases:

- Upon completion of the project;
- Where the project is partially completed. Where the part is separated from the entire project and with a record as provided for by law (e.g. if the part of the dwelling is sold and is used by the owners or may be used), the accrual principle can be used for this part for the recognition of incomes, despite the fact that still may be expected investments in the part of the business premises or garages/basements;
- If the taxpayer chooses to sign the sales contract as an accrual principle for the purpose of income recognition, it is considered eligible for tax purposes.

Lien

- If any long-term construction contract includes a provision for lien (retaining the percentage of the contract price until the period foreseen in the contract expires), for PIT and CIT purposes, these payments shall not be part of taxable income until the contractor receives them or is eligible to receive them from the client.

- Where such lien are paid to the contractor before they are due, provided that the contractor corrects any defects before construction work is handed over or accepted by the client, for PIT and CIT purposes, they shall be treated as taxable income in the period when the payments are received.

Determining the income of the "Investor" and "Investor-Contractor"

To determine taxable income according to the received advance payments or when there is a right to receive advance payments under contract, the cost of the period is recognized on the basis of the projected total project cost, as follows:

- Disaggregated projected total project cost per unit;
- The cost of sold goods is the result of the volume of units sold and the cost price per unit. The proportion between the means received and the sales value under the contract, serves as the basis for determining the proportion of cost recognition of goods sold for that tax period.
- In the last year of project completion, planned cost is harmonized with the real cost, and the possible deviation should be reflected in this period.
- In cases where no income is received, we have no project costs. Upon completion of the project, stock is created and records of the remaining stock should be maintained, as in any other industry.

Project cost

Project cost include, but not limited to:

- Costs directly related to the respective project;
- Costs attributable to the activity in general and may be accompanied to the building; and
- Other costs.

Costs directly related to a contract

Costs directly related to a contract include:

- Construction building-related labor costs, including supervision of works;
- Cost of materials used in construction;
- Depreciation of used construction equipment and machinery;
- Costs for moving the equipment, machinery and materials to and from the construction site/building;
- Costs of renting equipment and machinery;
- Design and technical assistance costs directly related to the project.

These costs may be reduced by any incidental income not included in the contract income, e.g. income from the sale of excessive materials and the sale of machinery and equipment at the end of the contract.

Costs that may be incurred by the contracting activity and that are allocated to specific contracts

Costs that may be incurred by the contracting activity in general and that are allocated to specific contracts include:

- Insurances;
- Design and technical assistance costs not related directly to a specific contract;
- Contract costs of a general nature.

Administrata Tatimore e Kosovës
Poreska Administracija Kosova
Tax Administration of Kosovo

Other costs

- Other costs that are specifically attributable to the terms of contract may include some general administrative and extension costs, reimbursement of which is specifically provided for in the contract.

- Costs that cannot be attributed to the project are the costs of sales, as well as costs of depreciation of inactive equipment and machinery not used in a particular contract.

Stock

Upon completion of the construction contract by the "Investor" or "Investor-Contractor", unsold assets shall be recorded **as inventory (stock)**.

Barter transactions

- Where there are barter transactions as part of long-term construction contracts, these transactions will be recognized as income or cost at a market value in accordance with the Law on Tax Administration and Procedures, at the time of the barter transaction.

- Barter transactions are regarded as the sale of goods or as a result of labor or service provided at market value.

- Tax invoices must be issued for barter transactions in the same manner as they were issued for cash transactions.

The moment of VAT liability arising on long-term contracts

Long-term contracts, including long-term construction contracts and long-term installation contracts, should be considered as completed:

- In the month of issuance of the interim payment certificate, but not later than one month after the issuance of the interim payment certificate in cases where the technical acceptance of works takes place later,
- In cases where one or more interim payment certificates are issued during the year, at the end of the year it is required to issue an interim payment certificate which will be based on the real measurement of the work performed, or
- If no interim payment certificate is issued during the year, then at the end of the year there will arise a liability to charge VAT based on the real measurement of work performed.

The moment of VAT liability arising on long-term contracts

- However, if the aforementioned works are not considered as long-term contracts, then they should be considered as completed at the time of issuance of the interim payment certificate.

- Any interim payment certificate of performed works must be accompanied by tax invoice.

- The term of payment, the possibility of deferment of payment or cred does not affect the moment of arising tax liability .

Exemptions not eligible to VAT deduction

The supply of houses, dwellings or the like, used for residential purposes, including garages and basements, are VAT exempted supplies that are not eligible to VAT deduction.

Eligibility to VAT deduction

Taxpayers engaged in long-term construction projects and contracts, from the VAT point of view, have taxable supplies and exempted supplies. As a result, there is a need to regulate the eligibility to VAT deduction.

VAT calculation by Investor and Investor-Contractor

- If the deductible VAT is related to transactions for which the VAT is deductible (where we have supplies eligible to VAT deduction) and not deductible (where we have supplies not eligible to VAT deduction), then only the portion of VAT attributable to transactions for which VAT is deductible.

- So, when it comes to Investor and Investor-Contractor, who provide mixed supplies (VAT deductible supplies and non-VAT deductible supplies) the deductible VAT proportion should be calculated.

Methods for calculating the provisional deductible proportion

The Law on VAT provides for three methods for calculating the provisional deductible proportion, such as:

- Provisional VAT deductible proportion based on real use (m^2);
- Provisional VAT deductible proportion based on real use (value);
- Provisional VAT deductible proportion by individual field of activity.

Provisional VAT deductible proportion based on real use (m^2)

- The deductible proportion based on this method is calculated on the basis of volume/unit in m^2, namely it is determined how many project units take part in taxable supplies and how many are exempted non-VAT deductible supplies:

Provisional Deductible Proportion (PDP) =
(taxable supplies (m^2) / taxable supplies (m^2) + exempted supplies (m^2)
x 100

- VAT deductible proportion should be determined on a yearly basis as a percentage and should be rounded up to an integer.

Example:

- If a project has 13,000 m² with a share of 3,000 m² in taxable supplies and 10,000 m² in VAT exempt supplies, the provisional deductible proportion will be:

Provisional Deductible Proportion (PDP) = (3,000 m2 / 3,000 m2 + 10,000 m2) x 100 =
(3,000 / 13,000) x 100 = 23.08 = 24%

- The percentage obtained on the basis of the above formula (24%) relates to purchases that will be used for mixed supplies, such as VAT deductible supplies and non-VAT deductible supplies.

Attention:

- Where there are several projects within a business, in terms of deductible proportion, the coefficient/proportion for each project should be calculated. For the purposes of the declarations, a summary of all transactions that occurred for each project should be created using the deductible proportion/lending coefficient obtained for each project, however, in these cases a simple average cannot be used.

- Provisional VAT deductible proportion method does not change in terms of method of calculation, unless there is a project annex or change of destination (from business to residential building and vice versa).

Provisional VAT deductible proportion based on the real use (value)

Provisional VAT deductible proportion method based on the real use (value), is mainly based on:

- Existing businesses - in previous year's transaction data; or
- New businesses - in the taxable person's own forecasts - the current year.

Provisional Deductible Proportion (PDP) =
(taxable supplies (value) / taxable supplies (value)+ exempted supplies (value) x 100

- Remark:

During the calculation of provisional VAT deductible proportion shall not be included the attributable turnover from the sale of capital assets, and the amount of the supply of financial services, if conducted on an irregular basis.

Provisional VAT deductible proportion, by individual field of activity

- The taxable person may determine the deductible proportion for each individual field of his activity separately, provided that he keeps separate records for each individual field of his activity, and provided that he notifies TAK on the method of determining the deductible proportion.

- The taxable person shall calculate the deductible proportion selected according to this criterion for at least twelve (12) months. If the taxable person wishes to change the deductible proportion calculation method again, he must notify TAK again of such change within fifteen (15) days before the beginning of the tax period for which period the new method will be used.

Treatment of land/parcel as a cost for business natural persons (Individual businesses)

In long-term contracts, the cost of project land/parcel may derive from the following transactions:

- As an asset purchased on behalf of the business;
- As an asset purchased on behalf of the owner;
- As an inherited asset;
- As an asset of barter transaction.

Purchase of land/parcel on behalf of the business

To be allowed as a cost of purchasing land/parcel on behalf of the business, it must be fully documented, which documentation should be available for inspection purposes when required by the Tax Administration. Documentation requirements are set out in the Law on Tax Administration and Procedures.

Purchase of land/parcel on behalf of the owner

To accept the cost of land/parcel purchased on behalf of the owner, the taxpayer must possess:

- Possession list;
- Land/Parcel Purchase Document;
- Document proving that the property is transferred on behalf of the business;
- Any other document proving the land/parcel ownership.

In such cases, the land/parcel cost, shall be accepted the purchase value in the purchase date.

Inherited land/parcel transferred to individual business

The cost of inherited land/parcel transferred by the owner (individual) to the Individual Business, will be the open market value of the land/parcel on the date of the transfer to the Individual Business.

Treatment of land/parcel as cost of legal person

In long-term contracts, the cost of project land/parcel may derive from transactions with the legal entity, as follows:

- As an asset purchased on behalf of the legal person;
- As an asset purchased on behalf of the shareholder, which is later transferred on behalf of the company;
- As an asset of the barter transaction.

Treatment of land/parcel as a cost of the legal person

- The land/parcel purchased on behalf of the legal person shall be treated the same as the Individual Business.

- Differently is treated if the property is registered on behalf of the shareholder and then transferred to the Company. In such cases the shareholder is obliged to transfer this land/parcel on behalf of the Company, which increases the shareholder's share in the capital. Increase of shareholder's share in capital is made through the amendment of the Statute and the Company's Agreement.

- In addition to the possibility of increasing the shareholder's share in the capital of the Company, the shareholder may establish other transactions, such as: in the form of a barter transaction or regular purchase between the shareholder and the legal person.

- In cases where the shareholder has a land/parcel, and transferres it to the Company, the value of the land/parcel is recognized as a cost to the Company.

Treatment of barter transaction

- As the moment of liability arising and the VAT charge on supplies of goods and services are determined, the same applies when we deal with barter transaction, such as: land/parcel, which is exchanged with construction building/commodity.

- In the event of a barter transaction, the value of the land/parcel from its owner as a non-business natural person to a natural or legal person (Investor) is equal (same) to the units of measurement (m^2) acquired, as defined by the contract.

- The contract price for such transactions, for taxation purposes, should be based on the open market value.

- In cases where we have a barter transaction, tax invoices must be issued in the same manner as they are issued for cash transactions.

Attention

With regards to barter transaction in relation to long-term projects and contracts between the landowner and the investor, respectively for the part of the landowner building (including dwellings, premises and garages, etc.), billing is mandatory upon determining the market value from supplies/sales within the building. If it is not possible to determine the market value during the following investments, then billing should be done at the end of the project (when the dwelling/premises/garage becomes available to the buyer) based on the real value.

Services/goods, which are exchanged with construction buildings

The service/goods provider as a contractor is obliged to make the recognition of the barter transaction income and cost according to the accrual principle, i.e. proportionally based on the completed percentage, which transactions are reflected in the investor. In this case, the investor makes complete billing (for the final product), as contracted for the part of the construction building, without dividing the entirety into parts.

Co-Investor

For the purposes of treating long-term construction contracts from a tax perspective, persons entering into barter transaction agreements shall not be considered as co-investors. Co-Investment shall mean joint investment, profit/loss sharing.

Creating and maintaining records on long-term construction contracts

- Companies involved in long-term contracts must maintain separate accounting for each separate project.

- If there are multiple contracts in the project, there should be separate accounting for each contract within the project. For each separate contract, there should be a separate accounting for all costs and incomes (per measurment unit, such as sales, payments, advance payments, etc.)

Creating and maintaining records on long-term construction contracts

- A person who is required to create registers according to tax legislation, shall be required to maintain those registers for a period of at least six (6) years after the end of the tax period, when such a relevant tax liability has arisen.

- In addition, records relating to assets that are depreciable over a period of more than six (6) years shall be maintained for the depreciable lifespan of the asset, plus an additional year.

- Asset-related records that require the determination of the basis for the treatment of capital profits or the determination of profit by their sale, shall be maintained until such assets have been sold or exposed for plus six (6) additional years.

Thank you for your attention!