CEE-CIS Tax Notes
Working cross-border*

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*connectedthinking
We are publishing the second electronic update of CEE-CIS Tax Notes 2005 before the summer holiday so that finance professionals will have a chance to read the tax and legal news in a more relaxed environment. Legislators seem to have spent a lot of time on drafting new acts and on refining existing ones in the second quarter of 2005.

VAT is definitely the hot issue in several countries in our region. For Serbia, VAT is a fairly new tax category. For the recent EU joiners, another level of VAT regulation has been implemented in accordance with the EU guidelines. In addition to VAT, transfer pricing is also a frequently discussed issue in our countries.

This publication is designed for informational purposes only. Rules and regulations are discussed in brief and general terms, and therefore should not be regarded as a substitute for appropriate detailed professional advice.
Fiscal treatment of the financial leasing in Albania

The Finance Leasing Act is relatively new in Albania. This law was approved by the Albanian parliament on 12 May 2005 with effective date 15 days after its publication on the official gazette. This law does not make any reference to the tax treatment of finance lease transactions, nor has it been followed by new guidelines on the tax treatment of such transactions. As part of drafting a new fiscal package, the government intends to include appropriate provisions regulating the taxation of financial leasing in the relevant tax acts.

The main tax issues involved in finance leasing are VAT and profit tax.

Based on the new law on VAT in effect from 1 January 2005, the leasing of goods is subject to VAT, currently at 20%. In accordance with the guidelines to the same law, the VAT is applied on the total value of goods/assets, or on the total amount of fee, i.e. instalment plus interest.

The Draft Instruction (DI) to the Law on Tax on Profit provides guidance on depreciation calculation, the depreciation rate and maintenance expenses. Based on the DI, the depreciation will be calculated by the lessee. Independent of the duration of the leased contract, the leased assets are depreciated at the same rate of depreciation as stated in the fiscal law. Maintenance expenses incurred by the lessee are deductible for the purpose of determining the taxable profit.
Change of Tax IDs

The process of moving to international standards of taxpayers’ registration has been initiated as part of the ongoing reforms of Azerbaijan’s tax system.

As one of the steps in that process, all taxpayers registered in Azerbaijan since October 2004 have been required to change their tax registration numbers to a new format. The process of changing taxpayers’ identifications (IDs) was initially expected to be completed by 1 January 2005. However, the deadline has been extended until 1 July 2005.

To implement the process, the Cabinet of Ministries of the Azerbaijan Republic issued a Decree “On Completion of the Inventory of Taxpayers and Issuance of New Tax Identification Numbers” on 17 May 2005.

According to the decree, taxpayers’ old nine-digit Tax IDs will become invalid from 1 July 2005. All documents, such as contracts, invoices, VAT and Import-Export certificates, accounting documents, issued from 1 July 2005 onwards must indicate a new ten-digit Tax ID of the taxpayer. Otherwise, such documents will be considered invalid, and tax and customs authorities and banks will not be allowed to accept these documents.

Corporate taxation

Double Tax Treaties

- Azerbaijan and Bulgaria are planning to sign a treaty on avoidance of double taxation during an upcoming official visit of the President of Azerbaijan to Bulgaria.

- The text of a draft treaty on avoidance of double taxation has been agreed by Azerbaijan and Qatar, pending formal signing by the parties.

Legal and other developments

Foreign currency regime

- The President has recently signed a decree for anti-inflationary measures. The National Bank of Azerbaijan (NBA) has been charged with the responsibility to make sure that no settlements on the territory of Azerbaijan are made in foreign currency (only in Azeri manats). The NBA has also been instructed to develop and present to the President a state program for developing a mortgage mechanism.

Natural Resources

Concessions

- Three more new oil and gas Production Sharing Agreements (onshore) have entered into force from 15 May 2005:
  - Agreement on the Rehabilitation, Exploration, Development and Production Sharing for the block including the area covering the Garachukhur fields between the State Oil Company of the Azerbaijan Republic (SOCAR), Noble Sky Ltd and an Affiliated Oil Company SOCAR.
  - Agreement on the Rehabilitation, Exploration, Development and Production Sharing for the block including the area covering the Binagadi fields, between SOCAR, AZEN Oil Company BV and an Affiliated Oil Company SOCAR.
  - Agreement on the Rehabilitation, Exploration, Development and Production Sharing for the block including the area covering the Kyurovdag fields, between SOCAR, Caspian Energy Group Ltd and an Affiliated Oil Company SOCAR.
Amendments to the VAT Act

Amendments to the Regulations for Application of the VAT Act were published in the State Gazette on 12 April 2005. The main amendments can be summarised as follows:

– The procedure for offsetting of VAT credit has been clarified, including the option for additional offsetting of VAT up to nine months following the initial three-month period for offset.

– It is explicitly stated that the coefficient for VAT recovery cannot be negative or higher than one.

– Some of the statutory forms for VAT reporting have been amended, such as the form for offsetting of VAT, the application for VAT registration and the monthly VAT return. The old version of the monthly VAT return can be used until 1 January 2006.

– Persons registered for VAT are obliged to charge VAT for public sales of pledged or mortgaged goods to satisfy creditors claims in accordance with the Civil Procedures Code and the Registered Pledges Act.

– As of 1 May 2005, banks, non-financial institutions, insurers, pension insurance entities and pension funds will be obliged to include interest received from current and deposit accounts in the calculation of their coefficients for VAT recovery purposes.

– The amendments entered into force on 12 April 2005 (except the paragraph immediately above).

Indirect taxation

Customs duties

• As of 4 June 2005 some amendments were introduced to the Customs Act:

  – In line with the recommendations of the EU Commission, the changes in the Customs Act introduce procedures for post-clearance customs control. The post-clearance control will be carried out by specialised units within the customs administration, which will check the correct application of the customs regimes, procedures and trade policy measures. The customs authorities will have broad powers in carrying out audits, which can last up to six months. Goods, warehouse availabilities, accounting records, commercial, accounting or other documentation could be audited. The implementation of the post-clearance customs control is expected to facilitate the application of the simplified customs procedures.

  – The amendments to the Customs Act introduce changes in the amount and means of determining the penalties for customs violations. Equal penalties for individuals and companies have been introduced. The penalties for some of the violations have been decreased.

• The trade in agricultural goods with the EU has been liberalized as follows:

  – As of 1 July 2005, an Additional Protocol to the Association Agreement between Bulgaria and the EU is expected to enter into force. According to this protocol, Bulgaria is reducing or removing the import duties for a large number of agricultural goods originating from the EU. These goods include: milk and dairy products, coffee, cocoa, oil and butter, and foodstuffs produced from vegetables and fruits. The EU is also reducing or removing the import duties for certain agricultural goods originating from Bulgaria.
**Hitro.hr service and reform of Land register**

In the second quarter of 2005, the Ministry of Justice introduced two new projects: the web-site www.hitro.hr service and the reform of the Land Register.

The aim of the Ministry of Justice web-site (www.hitro.hr) is to facilitate and expedite communication between citizens and the state administration. Limited liability companies can now be established in four steps, and the time necessary for establishing it has been reduced to only two weeks.

An important development is the beginning of the reform of the Land Register. The reform aims at creating a more efficient system of searching for information and at stimulating the development of the real estate market. The reform implies a harmonisation of the cadastre and Land Register data, the computerisation of land registers, and the introduction of a user-friendly research system. As of May 2005, it is possible to search Land Register data through the Internet. All of the Land Register data is expected to be available online by the end of 2007.

**Legal and other developments**

**Foreign currency regime**

- According to the Decision of the Croatian National Bank on the Manner and Conditions under which Residents Invest in Foreign Securities and Stakes in Foreign Investment Funds, Croatian residents can purchase/sell foreign securities without restriction, whereas for the purchase of stakes in foreign investment funds reciprocity is required. The decision is aimed at further liberalisation of the foreign exchange regime. Prior to this decision, investments in foreign securities made by residents were limited by the requirement that the country issuer be an OECD Member State or an international financial institution. Residents were allowed to purchase foreign securities other than those mentioned above, if the registered headquarters of their issuer were in an OECD Member State and if the long-term credit rating of their issuer or of the foreign security itself was from A to A2, according to the evaluation of at least one internationally recognised rating agency. Prior to investing in foreign investment funds, residents are obliged to check whether reciprocity exists with the country where the fund is based. Similarly, pursuant to the Decision of the Croatian National Bank on the Manner and Conditions under which Non-Residents Invest in Domestic Securities and Stakes in Domestic Investment Funds, all restrictions are abolished.

**Intellectual property**

- The Law on Representation in the Area of Intellectual Property Rights, which was passed in April 2005, brings changes to the manner of representation of parties in proceedings before the State Intellectual Property Office, as well as to the conditions and procedures of entries and deletions from the Registry of Representatives. The Law also envisages the establishment of a Bar of Representatives in the area of Intellectual Property rights. The Law comes into force on 1 August 2005.
Proposal to establish binding rulings for transfer pricing

A draft amendment to the Income Tax Act would make it easier for taxpayers to obtain binding rulings from the Financial Office regarding pricing for related party transactions.

Under the proposed amendment, a taxpayer who is uncertain whether pricing for a related party transaction complies with the rules governing such transactions can request a binding ruling from the tax authorities.

In general, related party transactions must be priced at a level comparable to transactions between unrelated parties (the arm’s length principle).

The proposed amendment, which is in harmony with OECD guidelines, would allow taxpayers at the outset of a related party transaction to obtain a binding ruling regarding the price level. This should alleviate uncertainty regarding pricing for various intra-group activities involving goods, services, or royalties.

If enacted, this provision should take effect for the 2006 tax period.
E-audit

In 2005, one of the priorities for the Estonian Tax and Customs Board is to implement an e-audit system. This should facilitate the work of the tax administration, as well as increase the efficiency of the process for taxpayers. According to the changes made to the Tax Procedure Act, from 1 July 2005, if a taxpayer carries out its bookkeeping electronically, it is obliged to present all documents electronically upon the regulating authority’s request within a reasonable period of time. These taxpayers can no longer submit their electronic bookkeeping in paper format. In addition, the law also prescribes that taxpayers must be able to process electronic documents maintained on certain readable data media for at least seven years.

Corporate taxation

Withholding tax

• At present, corporate profits are not taxed in Estonia until these are distributed either as dividends or as other taxable profit distributions (deemed dividends). At that point, these profits are generally subject to 24% corporate income tax (24/76 tax on the net amount of profit distribution). This rate is expected to be reduced to 20% by 1 January 2009 (and by 1% each following year).

On 20 April 2005, the Estonian Parliament passed amendments to the existing Income Tax Act with effect from 1 January 2005. These amendments make dividend distributions from two types of foreign source profits fully exempt from Estonian corporate income tax. Dividends distributed by Estonian companies will now be exempt from Estonian corporate income tax if these are paid out of:

– dividends received from foreign qualifying participation (at least 20% holding), provided that either the underlying profits have been subject to foreign tax or the dividends were subject to foreign withholding tax, or
– profits derived through a foreign permanent establishment (PE), provided that such profits were subject to tax in the country of the PE.

Dividends paid by Estonian companies out of dividends received from qualifying domestic participations (those with at least 20% holding) are also exempted from corporate income tax, provided that tax has been paid on the underlying profits.

The change from the previous credit method to this new exemption method for eliminating international double taxation was made in order to better align Estonia’s tax policy with the principles of a common market following Estonia’s accession to the European Union on 1 May 2004.

Individual taxation

Personal income tax

• From 1 July 2005, an amendment to the Tax Procedure Act requires foreign companies (without a permanent establishment in Estonia) acting as employers in Estonia, to register with the Regional Tax Centre of the Estonian Tax and Customs Board within 10 days from making any taxable payments. Up to 1 July 2005, the registration of such foreign companies as employers in Estonia was voluntary.

However, based on the current understanding of the Tax Authorities, tax registration would only become compulsory for those foreign companies, who have employed local employees covered by the Estonian social security system. If a foreign company has employees working in Estonia who belong to the social security system of their home country during their assignment in Estonia, then registration may not always be mandatory, even after 1 July 2005. In such a case, the individual employee may still be required to declare his/her Estonian source taxable income after the year-end by 31 March of the following year. This interpretation of the Tax and Customs Authorities should apply equally to companies resident in the EU and non-EU countries. However, the described understanding of the Authorities does not have a clear basis in the tax legislation and should therefore be clarified on a case-by-case basis.

• From 1 July 2005, business travel expenses (e.g. daily allowances, accommodation and travel expenses) reimbursed by an Estonian employer are tax exempt for an Estonian resident employee according to the established limits of the foreign country, if the principal place of work of that employee is in the foreign country. This applies regardless of whether the employee is working in a foreign country for an Estonian or for a foreign employer. However, the limits established by the Government of Estonia still apply to business travel expenses reimbursed to employees whose principal place of work is in Estonia.

Prior to 1 July 2005, the tax exempt limits of the foreign country applied only to the business travel expenses of resident employees who were employed by foreign employers to work in a foreign country.

In addition, if a non-resident employee is seconded by a foreign employer to work in Estonia, business travel expenses will be tax exempt in Estonia according to the established limits of the foreign country, from which the non-resident employee was seconded to Estonia. Finally, if a non-resident employee, who has a principal place of work in Estonia, is seconded to a foreign country, the tax exempt limits established by the Government of Estonia will apply.
Amendments to the Hungarian VAT Act

Some major amendments to the VAT Act were adopted by the Hungarian Parliament on 2 May 2005 and took effect on 1 July 2005.

Changes in the import VAT system

The amendments will restore the pre-accession levy system for most companies (where import VAT is payable together with the import duty), excepting only a few qualifying taxpayers who hold special Customs Authority permits.

The changes in the way import VAT is determined will obviously have an impact on the taxpayers’ right to deduct tax. Companies that will no longer be authorized to determine their VAT liability by self-assessment will have to finance the VAT charged on imported products and services. As under the pre-accession system, they will only be able to deduct the input VAT after the date import VAT is paid on the basis of the Customs Authority’s resolution (or, when the payment is offset against the customs security, the date on which the resolution is issued).

Place of supply in trilateral and chain transactions

In trilateral export or intra-Community transactions with ex-work or FCA delivery terms, in which products were not shipped from a Hungarian seller (A) to the buyer indicated on the invoice (B) but to an EU or third country entity (C) specified by B, the exempt treatment of A’s sale was open to question and represented a tax exposure. The amendment adopted by Parliament addresses this issue and offers a solution for a certain type of these transactions by providing that the place of supply in such chain transactions is where the registered office of the entity that arranges for the shipment is located. The amendment states that if B has completed or ordered the delivery from A to B, and does not prove otherwise, then B is deemed to have done so in its capacity as buyer. Under this provision and the newly introduced Section 14 (5) of the VAT Act, the transaction between A and B will be treated as an exempt intra-Community transaction or export sale. Please note that if C ships the products from Hungary either on its own or by hiring a carrier, the transaction between A and B will continue to qualify as a local supply and will be taxed in Hungary. It should also be noted, however, that subject to certain contractual arrangements, it could still be argued that A has completed an exempt intra-Community or export sale even if C is responsible for the delivery.

At present, it is not clear whether the Hungarian Tax Authority will treat the amendment as a rule that clarifies cases retroactively, or consider it as only applicable to transactions completed after 1 July 2005. If the Tax Authority adopts the second approach, certain aspects of the VAT treatment of chain transactions completed between the date of Hungary’s EU accession and 30 June 2005 will remain open to question. Alternatively, the Tax Authority may use an approach that combines parts of the old and the new regulations with respect to transactions completed before 1 July 2005. Please note that the Tax Authority enforces very strict standards (not always justifiably) with respect to the formal requirements of, and the information indicated in, CMR notes, which prove that the goods have left Hungary.

Intra-Community purchases

The conditions for deducting VAT charged on intra-Community purchases will become stricter with the amendments. When the amendments take effect, companies will only be allowed to deduct the tax assessed and declared in connection with intra-Community purchases if they are in possession of the underlying invoice. Please note that in certain cases the tax period in which the tax is payable may precede the period in which it is deductible.

Corporate taxation

Corporate tax

- Income derived from greenhouse gas emission trading will be taxed favourably. Fifty percent of the revenues from trading in greenhouse gas emissions in excess of the cost price of the transferred emission reduction units, is deductible from the corporate tax base. This provision can first be applied when determining the tax base and tax liability for the 2005 tax year.

Investment incentives

- Criteria concerning the development tax incentive have changed. Application of the tax incentive will no longer be subject to a licence issued by the Finance Ministry. Taxpayers will only be required to report the details of the underlying investment project. However, the Ministry of Finance license will still be required to apply the tax incentive to major investments where the project value exceeds EUR 100 million (at present value) over a period of three years.

- Taxpayers were required to report various kinds of information to the Tax Authority in connection with the corporate tax incentive available to them (cost, expenditures, intangible assets recorded in their books, tangible assets capitalised, etc.). This information was to be reported by 30 April 2004. According to the changes, companies will only be required to report to
defined in business days. For companies that do not qualify as legal entities, the court of registration has to make a decision within 15 business days regarding incorporation and within 25 business days regarding change registration. Deadlines applicable to legal entities are 30 business days for incorporation and 45 business days for change registration.

- The rules on electronic company registration will take effect on 1 September 2005 and may simplify and accelerate incorporation and change registration procedures as well as access to registered information. An amendment allows the inclusion in the Company Register of documents in languages other than Hungarian.

Other

Local business tax and innovation contribution

- Under an amendment effective from 1 January 2006, interest and royalty income will be excluded from the local business tax and innovation contribution base of all companies other than banks, financial enterprises, insurance companies and investment firms. This measure will allow companies involved in intra-group financing or deriving significant royalty income to achieve considerable savings.

Other

Legal and other developments

Accounting

- An amendment to the Accounting Act expands the range of companies allowed to prepare simplified financial statements. Criteria change as follows:
  - the balance sheet total limit has been raised from HUF 150 million (approximately EUR 600,000) to HUF 300 million (approximately EUR 1,200,000)
  - the annual net sales revenue limit has been raised from HUF 500 million (approximately EUR 2 million) to HUF 1 billion (approximately EUR 4 million)
  - the employee headcount limit remains at 50

The company must meet at least two of these criteria, and this rule may already be used when preparing the financial statement for the 2005 financial year.
Projected Amendments to the Tax Code

At the end of April, a package of Draft Tax Code amendments was submitted for consideration of the Majilis, the lower chamber of the Kazakhstan Parliament. Notable Tax Code amendments are discussed below.

Tax incentives

– An expansion of the scope of tax incentives to include a 100% corporate income tax holiday (100% exemption) for eligible taxpayers operating in Special Economic Zones (SEZ).

– Addition of textiles to the list of business activities eligible for tax incentives.

– Tax incentives are not available for subsurface users, producers of excisable goods, and organisations acting under special tax regimes or under investment tax preferences even if they are operating in SEZ.

– An extension of VAT exemptions to sales of certain goods, works, services within the SEZs, including construction services and sale of buildings to SEZ participants.

– Zero-rate VAT for sales of building construction materials for those SEZ-qualified activities (with exceptions), including the right for a VAT refund.

VAT

– VAT registration threshold increased from 12,000 to 15,000 Monthly Calculated Indices (1 MCI is currently approximately USD 7.5).

Subsurface

– Negotiable increases to upper percentage of contractor’s share in profit oil.

– Production thresholds to be determined by each Product Sharing Agreement (PSA).

– Government take (for purpose of applying top-off tax) can be negotiated down to 5%.

Corporate Taxation

Investment incentives

• Effective from 4 May 2005, the Investment Law was amended to repeal the five-year limit for investment tax privileges. The period of the investment tax privileges would now be determined through the competent authority’s consideration of each particular case, depending on the industry and the amount invested.

• The Investment Law amendments reinforced monitoring and control over compliance with the investment projects’ claimed conditions. Specifically, the investor is subject to obligatory quarterly and annual reporting and may be monitored through site visits by the competent authority.

Indirect Taxation

VAT

• The Protocol to the Kazakhstan-Russian Indirect Tax Treaty entered into force on 1 February 2005, after the exchange of diplomatic notes between Kazakhstan and Russia. Thus, effective from 1 February 2005, VAT on mutual trade of all goods between Kazakhstan and Russia, with no exceptions, should be charged based on the destination principle.

Customs duties

• Amendments to the Investment Law effective from 4 May 2005 grant investment projects five-year exemption from customs duties on the import of equipment.

• Currently all equipment imported for the purposes of investment projects are exempt from import custom duties.

Taxation of Subsurface Users

Draft PSA Law

• On 20 April 2005, the lower chamber of the Kazakhstan Parliament, the Majilis, approved the draft “Agreement on Production Sharing Oil Operations on Sea”. The scope of the draft PSA Law is limited to offshore projects.

• Notable provisions of the draft PSA Law, among others, include:

  – the definition of a PSA and its terms
  – competence of the relevant state authorities
  – tender procedures for the offshore blocks
  – procedure for concluding, assignment, and terminating a PSA
  – operatorship
  – taxation
  – accounting terms
  – stability of the PSA terms, and
  – dispute resolution

• The draft PSA Law does not provide a detailed description of specific tax terms of the PSA contracts, instead offering a general reference to the Tax Code provisions. Notably, the draft PSA Law envisages a possibility for maintaining statutory (i.e. Kazakhstan) bookkeeping in a foreign currency, whereas the Tax Code requires recoverable costs to be maintained in Tenge (the Kazakh national currency).
Latvia aims to curb inflation

Latvia is currently experiencing relatively high inflation. Economists are seeking answers to why this might be happening, although Latvia’s accession to the European Union is frequently blamed.

Solutions have been proposed to curb inflation, especially dramatic increases in the prices of energy and food. This is a very sensitive area because of the relatively low income of Latvian citizens with little spare capacity to cope with this unexpected rise in costs. To mitigate the impact of this economic trend, food producers have proposed a reduction of VAT on food from 18% to 9%. The Ministry of Finance is reluctant to accept the proposed amendment, but the Ministry of Economy is working on reducing the VAT rate still further to 5%. The outcome will be announced fairly quickly, as there is pressure to take a smart decision and put the economy back in order.

Another proposal in the pipeline concerns personal income tax. With the current rate of 25%, self-employed business persons are struggling under a much heavier tax burden than companies, which are only subject to 15% tax on business profits. As a result, several proposals are under discussion as to what rate would be the most appropriate for self-employed business persons. In addition, there are plans to allow self-employed business persons to use simplified bookkeeping procedures in order to encourage people having little or no knowledge of bookkeeping to set up a business without hiring an accountant.

Corporate taxation

Double Tax Treaties

• The Latvian parliament has recently amended the Double Tax Treaty between Latvia and Italy. The Italian parliament has yet to ratify these amendments because when the treaty was signed in 1997, the Italian tax system included a tax called ‘corporate property tax’. This tax was abolished 1998, but the treaty still contains a reference to it.

Indirect taxation

VAT

• At the meeting of State Secretaries held on 26 May, the Ministry of Finance put forward a draft regulation ‘VAT treatment for imports of goods, for supplies of goods, for intra Community acquisitions of goods and for services paid from foreign financial aid funds’.

The draft Regulation states that the VAT treatment it prescribes does not apply to projects co-financed by SAPARD, EU structural funds, the Cohesion Fund or EC initiatives.

To ensure that the ISPA projects in progress are successfully implemented in line with the tax treatment prescribed by the financial memoranda, the draft Regulation states that within the meaning of this Regulation, the VAT treatment will only apply to those ISPA projects started before 1 May 2004.

To avoid problems with VAT treatment, the draft Regulation prescribes 0% VAT for intra Community acquisitions of goods and services acquired from persons established in other Member States and paid from foreign financial aid funds.

Excise duties

• The Cabinet of Ministers has passed a regulation introducing new excise return forms for the following products:
  – oil products
  – alcohol
  – tobacco
  – coffee
  – soft drinks

Other

• A working group comprising representatives from various fiscal institutions and business entities has agreed to review the need to improve the penalty system. The current 100% penalty for an unpaid tax liability may be reduced in the near future.
Ongoing tax reform

The amendments to the basic tax laws, such as the Law on Profits Tax, the Law on Personal Income Tax, the Law on Social Tax and the Law on Real Estate Tax, came into force on 18 June 2005.

Tax reform was commenced in the beginning of 2005 due to the Government’s plans to abolish payment of contributions to the Road Fund, which were calculated on turnover, to decrease personal income tax, and to avoid a decline in budget revenues by offsetting the deficit with new taxes.

According to the changes approved, the personal income tax rate will be reduced gradually from 33% to 24% within three years (to 27% as of 1 July 2006, to 24% as of 1 January 2008). Moreover, the real estate used by individuals for commercial purposes would be subject to 1% annual real estate tax and a social tax of 3% in 2006, and 4% in 2007, calculated on profits, also to be introduced on a temporary basis. Social tax would increase the total amount of taxes paid on profits up to 19%. The majority of businesses and individuals oppose introducing new social and personal real estate taxes.

Corporate Taxation

Double Tax Treaties

- The Lithuanian Parliament approved the Double Tax Treaty signed between Luxembourg and Lithuania. The treaty will come into force as of 1 January 2006.

Individual taxation

Pensions

- As of 1 July 2005, basic social pension will be increased to LTL 200 (EUR 58). The pension paid out by the Social Security Board consists of a basic pension and an additional pension.

Legal and other developments

Labour code

- On 4 April 2005, Government Decision No. 361 “Regarding the Increase of the Minimum Monthly Salary” was adopted. As a result, the minimum monthly salary will be increased from LTL 500 (EUR 145) to LTL 550 (EUR 160) as of 1 July 2005. The new minimum monthly salary will increase entities’ payroll costs, will influence calculation of the length of pension insurance and the coefficient of personal income to be insured.

- On 7 May 2005, the Law on amendments to the Labour Code came into effect. According to these amendments, an employer, when dismissing an employee and paying him/her all settlement payments (e.g. severance pay, salary, unused vacation) on the settlement date, is not required to complete an employee social insurance document. At the request of the employee, the employer is obliged to issue a certificate on which, in addition to other required information, the reason for the dismissal must be stated.

- On 28 May 2005, another Law on amendments to the Labour Code came into effect. As a result of these amendments, companies financed by either the State or by Municipalities are obliged to adhere to Government decisions regarding moving workdays to fit better with holidays. These decisions may be followed by other organisations on a voluntary basis.

- From now on, when terminating an employment contract, if an employee has not taken holiday for a period greater than one year, monetary compensation should be paid out for all unused annual vacations. Previously, the monetary compensation was paid for the maximum period of three years.

- On 28 May 2005, a new Law on Guarantees for Seconded Employees came into effect. This Law, which is in accordance with the European Council directive regarding employees seconded in the system of services provision, ensures guarantees for employees seconded to another Member State or to Switzerland, Norway or Iceland, as well as for employees seconded to Lithuania.

According to this Law, those laws which are applicable in the country to which an employee has been seconded also apply to that employee. Employers should follow the rules of any other EU country regarding the maximum working time and minimum resting time; minimum annual paid vacation; minimum salary; labour conditions for temporary working employees; safety and health conditions and hygiene norms; protection of young employees, pregnant women, and women who have recently given birth and are breast feeding; and discrimination at work.

However, if the laws of a country applicable to employment relations provide for more favourable conditions, those laws shall be applied. According to this law, daily allowances are treated as a part of the minimum wage.
The following articles illustrate the recent tax and legal initiatives which have taken place in Macedonia:

Allocation of a part of the tax revenues to municipalities

Municipalities’ mayors will acquire more authority as a result of the new process and law on decentralisation, which means that a portion of tax revenues will go directly to municipalities’ budgets. Mayors still do not know what portion of the tax revenues will be allocated to municipalities, despite the fact that decentralisation will start in the first two weeks of July. Under this law, 50% of VAT will be allocated to municipalities according to the number of the municipality citizens. It is still being negotiated whether any of the remaining 50% will also go to the municipalities. Three percent of each personal income tax payment will also be transferred to municipalities’ budgets.

New provisions in the Law on Bankruptcy Procedure

According to the Draft Version of the new Law on Bankruptcy Procedure, bankruptcy managers will be obliged to make provisions against potential damages resulting from their activities. They must set aside EUR 500,000 – in cash, bank guarantees or mortgages – on their property, to ensure that the procedure will be carried out honestly and efficiently.

The second relevant change is the role of the bankruptcy manager. He will have rights and responsibilities to manage the procedure, but the creditors will have the main word and final decisions. The third important change is the duration of the bankruptcy procedure, which is now to be limited to six months.
Moldova creates investment-friendly climate

On 18 February 2005 the Parliament of the Republic of Moldova passed the investment incentives program “Proinvest” for the years 2005-2006.

The program aims to improve the public administration mechanisms for investment activity in the Republic of Moldova by eliminating the administrative barriers which arise when entrepreneurial activities are initiated, and by assuring fast implementation by public authorities of the provisions regarding the enterprise registration and the beginning of its operations.

The Government will ensure the administration and co-ordination of the program, and the Investment and Innovation Department of the Ministry of Finance will be in charge of its implementation. The Moldovan Export Promotion Organisation will be the program’s independent auditor and will control the program implementation from the beneficiary’s point of view.

One example of recent investments is the International Free Port Giurgiulesti (Port), which has been created to increase economic development in the southern region of Moldova and to ensure the country’s fuel and energy security. The law has established a special legal regime for residents operating in this port.

The Port is incorporated for a period of 25 years.

The total surface area of the Port is up to 120 hectares and consists of:

- an oil-loading terminal
- a freight terminal
- a passenger terminal, and
- a development terminal

The various investment incentives and VAT and customs exemptions related to the Port are detailed in the relevant sections.

Corporate taxation

Corporate tax

- Organisations from the fields of science and innovation accredited by the National Accreditation Council are totally exempt from the payment of income tax, provided that the exempt income tax is used to finance innovation or any science-related projects established under the Science and Innovations Code.

- The following transactions are exempt from VAT:
  - Domestic goods first exported and then re-imported in the same condition into the country within a three-year term are exempt.
  - Goods placed under the customs regime of temporary admission and the products processed under the customs regime of outward processing relief are exempt.

Investment incentives

- Companies – Port residents, making capital investments in an amount equal to USD 5 million are exempt from income tax for five consecutive years from the fiscal period in which the company reached the aforementioned amount of capital investment and declared taxable income, beginning with the fiscal period when the company declared its taxable income. Residents which made additional capital investments exceeding USD 5 million are entitled to an additional income tax exemption for two consecutive years, subsequent to the fiscal period in which the company reached the above-mentioned level of investment and declared taxable income.

- The income of residents derived from operations in the Port will be subject to income tax at the following rates: 25% of the established income tax rates during the first ten years following the tax period in which port residents registered taxable income, and 50% of the established income tax rates during the remaining term of the law.

Indirect taxation

VAT

- The following VAT exemption have been granted to the Port:
  - Imports of goods or services to the Port from abroad or exports of goods or services from the Port abroad are exempt from VAT.
  - Goods or services imported to the Port from Moldova are subject to a zero VAT rate.
  - Supplies of goods or services, performed within the Port territory among its residents and residents of other Moldovan free economic zones are exempt from VAT.
– Goods imported by legal entities for non-commercial purposes, the customs value of which does not exceed EUR 50 are exempt.

– Services imported and delivered by organisations from the science and innovation fields accredited by the National Accreditation Council are subject to zero VAT rate. The services delivered by the organisations are exempt from VAT.

• The Moldovan tax authorities are considering introducing special bank accounts to be used for VAT settlement payments, covering all transactions subject to VAT, including claiming and receiving VAT reimbursements from the tax authorities. The funds from the special VAT accounts would not be used for any purpose other than VAT settlement payments. Each transaction subject to VAT would be documented with two payment orders to banks: one for the transaction amount without the VAT, and the other for the VAT amount.

Customs duties

• The following goods are exempt from customs duties related to Port:

  – oil products introduced to the customs territory of the Republic of Moldova through the Port, or through other customs units, and which are destined for sale via commercial units, incorporated under the conditions of the Giurgiulesti Port Investment Agreement
  
  – goods and services imported with the purpose of their investment within and under the conditions of the aforementioned Investment Agreement
  
  – goods imported for subsequent investment within and under the conditions of the Investment Agreement
  
  – oil products

• The following transactions are exempt from customs duties:

  – Technological equipment, devices, installations, and floating assets imported by accredited organisations from the fields of science and innovation are exempt from customs duties, provided the imports are made within the limits established by the Parliament on a yearly basis, and are destined for use in science and innovations.

  – Domestic goods first exported and then re-imported in the country within three years in the same condition, and the products processed under the customs regime of outward processing relief are exempt.

  – The goods imported by legal entities and placed under the import customs regime, provided that these goods are not intended for commercial activity and their customs value does not exceed EUR 50 are exempt.

• Other amendments and additions to the Customs Code of the Republic of Moldova refer mainly to the customs regimes, customs duty, customs liability, payment of customs liability, access of customs officers to the customs territory, etc.

Excise duties

• As a result of amendments to the Tax Code, excise duty is not charged on:

  – excisable goods imported to the Port from abroad or other Moldovan economic zones, as well as exports abroad originating from the Port (Excisable goods exported from the Port to Moldova are subject to excises under established procedure.)

  – domestic goods first exported and then re-imported in the country in the same condition within a three-year term, and the products processed under the customs regime of outward processing relief

  – goods imported by legal entities for non-commercial purposes, the customs value of which does not exceed EUR 50

• The list of excisable goods and licenses subject to excise duty was completed with some new tariff numbers.

Business transformations

• The Moldovan Parliament has cancelled the changes to the Act on Joint-Stock Companies according to which joint-stock companies must pay shareholders no less than 30% of net profit in dividends.

Other

• Parliament passed the bill on Leasing after three readings.

  Concerning new developments on securities trading, the Regulations on the prevention and detection of money laundering on the securities markets were adopted. The Regulations establish that both the professional participants and the securities-market brokers are obliged to gather, analyse and register the information on their clients, to fill in a special form for each transaction performed by an individual if it exceeds MDL 300,000 (EUR 19,800), and for each transaction performed by a legal entity, if it exceeds MDL 500,000 (EUR 33,000). This form must be submitted to the Centre against Economic Crime and Corruption within 15 days.
Amendment to VAT Law

On 21 April 2005 the Polish Parliament passed an amendment to the VAT Law which includes new provisions related to “bad debt” relief as well as amended rules on deductibility of input VAT related to purchasing vehicles. The amendment came into force on 1 June 2005 with the exception of the provisions related to the vehicles that will come into force on 22 August 2005.

Bad debt relief

The bad debt relief provisions allow companies to adjust output VAT downward if a VAT-taxpayer supplied goods or services and the corresponding receivables appeared to be uncollectible. The aim of the new provisions is to improve the situation of businesses that supplied goods or services to entities that turned out to be unreliable. Until 1 June the full amount of output VAT calculated on such supplies increased the supplier’s tax burden. Now the tax burden can be shifted towards the unreliable contracting party.

Under the amended VAT provisions, the supplier will be entitled, subject to a number of conditions, to decrease the output VAT related to uncollectible receivables; the other party to the transaction will be, in turn, obliged to correspondingly decrease the input VAT, or if it is not enough, increase the output VAT.

Purchasing vehicles

Based on new provisions related to purchasing vehicles, the input VAT related to purchased passenger cars and other similar vehicles will be deductible within the increased limit. Starting from 22 August, the VAT taxpayer will be entitled to deduct 60% of such input VAT, but no more than PLN 6,000 (approximately EUR 1,500) per car. Under the currently applicable provisions (before this part of the amendment comes into force), the respective limits are lower, i.e. 50% of the input VAT and no more than PLN 5,000 (approximately EUR 1,250) per car.

Furthermore, the amended provisions introduced a new definition of vehicles that will be subject to the limited input VAT deductibility. Starting from 22 August the 60% and PLN 6,000 (approximately EUR 1,500) limits will concern (subject to a number of exceptions) vehicles with total acceptable weight not exceeding 3.5 tons. Purchasing other vehicles (i.e. vehicles of the total acceptable weight exceeding 3.5 tons) will not trigger any restrictions related to the input VAT deductibility.

It should also be noted that the discussed restrictions will not concern deductibility of input VAT paid by the taxpayers which sell and lease vehicles within the scope of their core business. These taxpayers will be entitled to deduct input VAT related to any purchased vehicles (including those below 3.5 tons) in the full amount. This rule exists also under the current legislation before the discussed amendment comes into force.
Important steps towards EU accession

Romania signed the European Union accession treaty on 25 April 2005, paving the way for the country to join the bloc in 2007. However, Romania must still move fast on key measures such as harmonising its legislation with the European acquis, encouraging free competition, attracting investments and improving the business environment.

On 1 January 2005, a flat-rate individual income tax of 16% was introduced, replacing the four-bracket system. During the past three months several attempts have been made to apply the same flat rate to other types of income, such as income from investments and real estate transactions (previously untaxed). As changes had occurred in the middle of the fiscal year, transitional provisions and special circumstances will apply, depending on the type of security, date of purchase or length of ownership. Details of these circumstances are presented below.

Corporate taxation

Corporate tax

- The reduced 10% tax rate on capital gains from sale-assignment of shares and immovable property has been abolished.

- The option to tax the revenues from purchases made under an instalment credit plan, at the moment an instalment is due, is no longer applicable. Nevertheless, taxpayers who opted before 30 April 2005, benefit from this provision until the instalment plan is terminated.

- The possibility to depreciate an initial 20% of the entry value of fixed assets at the moment of commissioning, is abolished. Taxpayers who benefited from this provision before 30 April 2005 are obliged to retain such fixed assets in their patrimony for at least half of their useful life.

Withholding tax

- Revenues obtained by non-residents from interest on time deposits, certificates of deposits and other savings instruments held in banks and other authorised credit institutions based in Romania, are subject to 10% withholding tax, if they are created/acquired after 1 June 2005.

- Revenues obtained by non-residents from interest on demand deposits and current accounts opened with banks or other credit institutions in Romania are exempt from withholding tax if the interest rate is lower than or equal to the interbank interest rate for one-month time deposits denominated in the same currency. Revenues from interest on deposits in mutual benefit funds are also exempt.

- Revenues from Romania obtained by non-residents from international transport and supply of ancillary services thereto are exempt from withholding tax as of 1 January 2005.

- As of 1 January 2006, a 16% domestic withholding tax rate will be levied on revenues obtained by non-resident individuals and legal entities. This rate could be reduced by the application of Double Tax Treaties. Revenues from gaming, however, will continue to be taxed at 20%.

Indirect taxation

VAT

- As part of the EU harmonisation of the Romanian VAT Act, starting 4 June 2005, certain operations such as activities of private radio stations, television stations and TV cable providers, as well as the sale of film or programmes licenses and broadcasting rights intended for radio and TV activities are no longer exempted, but taxed with 19% VAT. Also, cinema tickets are subject to the reduced VAT rate of 9% as of 4 June 2005.

Customs duties

- The incomplete declaration procedure and the simplified declaration procedure became operational in April 2005. Moreover, the local customs clearance procedures and the simplified/incomplete declaration procedure can now be applied simultaneously, leading to further simplification of the customs-clearance-related formalities, and time and cost savings.

- The Romanian Integrated Customs Tariff (i.e. TARIR, which is in line with TARIC) was enforced at the beginning of June 2005. The Romanian Integrated Customs Tariff contains the duty rates applicable to all goods, as well as the special conditions that may apply to goods at import and export.

- The Treaty of EU Accession with Bulgaria and Romania was signed on the 25 April 2005. The Treaty includes special provisions regarding the status of the goods in the enlarged Community and the discharge of suspensive customs regimes begun before the date of the accession.

Excise duties

- On 1 April 2005, excise duties increased both for harmonised products (e.g. alcoholic beverages, tobacco products, petroleum products), as well as for non-harmonised products (e.g. new and second-hand vehicles, perfumes, yachts, etc.). Also, electricity became subject to excise duties but, conversely, excise duties have been eliminated for electronic products, such as video products, stereo systems, radio-double cassette decks, as well as cameras.
• For cars purchased under leasing agreements concluded after 1 April 2005, the taxable amount for excise duties has been increased to the entry/acquisition value of the cars (from the residual value at the end of the leasing period, as before).

Individual taxation

Personal Income tax

• As mentioned in the previous edition of Tax Notes, as of 1 January 2005, a 16% flat tax rate for profit and salary income came into force. However, tough negotiations with the IMF and the expected decrease in state budget revenues had to be compensated, especially at the individual level, by an increase in certain tax rates, as well as by the introduction of a new one.

In early June, the Romanian Parliament finally approved the Government’s Ordinance issued in December 2004, which introduced the 16% flat tax rate, and have been amending it consistently, especially regarding the taxes for investment income.

– Interest income obtained from term deposits, civil contracts (loan agreements between individuals or companies without financial institution involvement) or any other saving instruments created after 1 July 2005 is taxed at 10%. After 1 January 2006 the rate will increase to 16%, except for the interest income from demand deposits and current accounts, which is tax free, provided the interest rate is lower than or equal to the interbank interest rate for one-month time deposits. (Prior to 1 January 2005, the tax rate on this type of income was 1%.)

– Capital gains can be derived from the transfer of securities, other than fund units in open investment funds and shares in limited liability companies. Up to 31 May 2005 only the positive difference between the sales prices and purchase prices adjusted the tax base. From 1 June 2005 capital losses are also taken into account when determining the tax base. The capital gain obtained from the transfer of these types of securities is calculated on the date the transaction is concluded, based on the contract between the two parties. The earnings are determined at fiscal year end, taking into account the entire portfolio of securities a taxpayer has transacted during the year, as the positive difference between losses and gains registered during the year from the transfer of securities, except for securities received under the “mass privatisation programmes”.

The tax rate on investment income is 1% in the following situations:

– on the earnings obtained from the transfer of securities acquired before 31 May 2005, irrespective of the date they are sold (this tax is not to be adjusted further)
– on the earnings obtained from the transfer of securities acquired and sold during the period between 1 June 2005 and 31 December 2005 (this tax is not to be adjusted further)

– on the earnings obtained from the transfer of securities acquired after 1 June 2005, sold after 1 January 2006 and held for more than 365 days

The tax rate is 16% on the earnings obtained from the transfer of securities acquired after 1 June 2005, sold after 1 January 2006, and held for less than 365 days (this tax is to be further adjusted).

Losses resulting from term currency sale-purchase agreements cannot be fiscally carried forward, and the tax paid is final. Earnings from term currency sale-purchase agreements, obtained during the period between 1 June 2005 and 31 December 2005, will be taxed at 10%. After 1 January 2006, the tax rate will increase to 16%. The tax is calculated, withheld and paid by the intermediaries. (Prior 1 June 2005, the tax rate for this type of income was 1%.)

The Romanian Government has just introduced a tax on income from real estate transactions. The law provides for the method of establishing the price for the purpose of taxation. Losses generated from real estate transactions cannot be carried forward. Gains obtained through the transfer of real estate properties during the period 1 January 2005 and 31 December 2005 will be taxed at 10%. After 1 January 2006, the tax rate will increase to 16%.

Legal and other developments

Competition law

• The Competition Council has issued Guidelines on informal guidance relating to novel questions concerning Articles 5 and 6 of Competition Law no 21/1996, that arise in individual cases (guidance letters). As per the Guidelines, an undertaking having entered or intending to enter into an agreement or practice that raises novel questions as to the interpretation and application of Articles 5 and/or 6 of Competition Law may request the informal guidance of the Competition Council. When issued, the Competition Council’s guidance letter would set out a summary description of the facts on which it is based and the interpretation given by the Competition Council to the novel questions raised by the request. Guidance letters are not decisions and are not binding on the Competition Council.

• The newly issued Regulation laying down the formal investigation procedure applicable to state aid transposes the European Council Regulation no 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty. A new regulation on state aid rules applicable to the cinema and television sector was issued, setting out the principles and specific compatibility criteria for state aid granted for cinema and television program production. Also, guidelines have been issued to regulate the computation of interest rates applicable in cases of illegal or prohibited state aid that is to be recovered from the beneficiary.
Extension of accreditation of representative offices

Article 55 of the Civil Code of the Russian Federation states that foreign legal entities (FLE) may directly carry out commercial activity only through a registered branch.

Historically, a number of FLEs have carried out their commercial activity in Russia through representative offices despite the express provision of the Civil Code of the Russian Federation, in Item 1 Article 55, that representative offices may fulfill only representative functions and protect the interests of the legal entities that they represent.

In practice, however, Russian state agencies have not challenged such practices and allowed the functions of a representative office to overlap with those of a branch. In recent months, the Russian Ministry of Finance, together with the Federal Taxation Service decided to prohibit this practice of using a representative office to carry on profit-generating business for a FLE.

Possible reasons for the acceptance of this practice in the past may have been the great number of state agencies that had the right to accredit representative offices and the inconsistent approach that some of them took in applying the Civil Code.

Presently, most FLEs have to apply for accreditation either to the Russian Chamber of Commerce and Industry or the State Registration Chamber. These two bodies had consistently taken a position that strictly adhered to the law governing representative offices and branches.

It is important to note that, in processing a first-time accreditation of an FLE’s representative office or the extension of an accreditation, the documents submitted, including the regulations for the representative office, are usually reviewed by the lawyers of these accreditation agencies to determine their conformity with Russian law, and, in particular, the conformity of the proposed activity of the representative office with Article 55 of the Civil Code of the Russian Federation. If the proposed activity can be considered commercial, this may provide the grounds to deny the accreditation of the representative office or the extension of the accreditation.

In addition, it is worth noting that branches of FLE’s are registered exclusively by the State Registration Chamber.

In view of these policy changes, FLEs that carry out commercial activities through accredited representative offices may consider re-registering as branches prior to the expiration of the accreditation of their existing representative offices.

Indirect taxation

Customs duties

- According to the Russian Government Resolution No. 166 of 29 March 2005 importers are entitled to reduce import customs duty rates on car parts imported for the industrial assembly of cars. Certain criteria were established for application of such reduced rates (e.g. conformity with annual production capacity requirements, production operations). In order to apply the reduced rates of customs duties, Russian companies (importers) must conclude Agreements with the Ministry of Economic Development and Trade of the Russian Federation (MEDT), which should be also approved by the Ministry for Industry and Energy of the Russian Federation.

- The MEDT issued regulations governing application of the simplified customs clearance procedure (e.g. temporary storage of goods at the applicant’s warehouse, preliminary declaration with incomplete customs declaration or incomplete periodic customs declaration, declaration of goods under customs control at the declarant’s warehouse with submission of periodic customs declaration and release of goods prior to submission of customs declaration). Using these simplified procedures would allow importers to reduce logistics and customs-related costs.

Legal and other developments

Competition law

- The Russian competition law has been amended, with effect from 11 March 2005. In particular, certain thresholds for transactions requiring notification/approval by the Russian Federal Antimonopoly Service (FAS) were increased. For instance, under the new rules notification on appointment of General Director, Board of Directors, state registration of a legal entity should be directed to the FAS, if the combined book value of assets of all its founders exceeds 2,000,000 times the statutory monthly wages (approximately EUR 5,700,000). Previously this threshold was established at the level of 200,000 times the statutory monthly wages (approximately EUR 570,000). Also a preliminary approval of certain transactions is required from the FAS if the combined book value of assets of all its founders exceeds 30,000,000 times the statutory monthly wages (approximately EUR 85,700,000) – previously 200,000 times the statutory monthly wages (approximately EUR 570,000).
VAT in Serbia

There is already evidence that the introduction of VAT is having one desired effect: state revenue from taxes on consumption is over 40% higher (according to the Ministry of Finance website) than during the same period in 2004.

A summary of some of the new law’s highlights is detailed below.

**Rates and exemptions**

The reduced rate (8%) is arguably high. Serbia has resisted the temptation to use a low and extended reduced rate. The reduced rate also has a commendably narrow scope. More recently, a reduced rate for the first-time sale of property has been included.

Exemptions from VAT without a right to deduction include: financial services – described as trading in money and capital; insurance and reinsurance services; land; structures; rental for residential purposes; trading in shares and securities; public postal services; certain educational, cultural and medical supplies and gambling organization.

In a similar fashion to EU law, the place of supply for financial services is where the recipient is based. However, Serbia allows a deduction for supplies made outside Serbia only in the event that the supply would give rise to a deduction if performed in Serbia and, therefore, there is no deduction for financial services performed outside the country.

**Deduction**

For taxpayers who are not fully taxable, deductibility is a percentage based on the ratio of trade giving rise to outright deduction to total trade in goods or services in the period from 1 January in the current year until the end of the relevant tax period. This contrasts with the alternative of allowing a full deduction where costs can be fully attributed to taxable activity and denying deduction for costs which can be fully attributed to non-deductible activities before applying the apportionment.

The application of a flat proportional deduction rate is both inequitable and undermines the principal of neutrality in VAT. It appears this issue will be addressed soon.

**Capital assets**

The Serbian VAT Act contains a capital goods scheme to make adjustments for equipment and installations. There is an obligation to correct a deduction (within five years of the acquisition of equipment and ten years of the acquisition of a structure) when the conditions for deduction are no longer being met. The taxpayer is also required to make an adjustment on the sale of a structure within the relevant period. Guidelines issued by the Ministry of Finance imply a taxpayer is required not only to charge output tax on the sale of a capital asset within the relevant time period but also to make a repayment of reclaimed input tax regardless of whether the sale is a taxable one or not. This forces double taxation on the taxpayer (Article 32 Serbian VAT law).

Clearly there are a number of issues that need to be addressed. Key to the development of a healthy VAT system in Serbia (and it seems to have started well) will be the willingness of government to engage in a meaningful dialogue with the key users.

**Corporate taxation**

**Corporate tax**

- Although the Corporate Income Law was last modified in 2004 in Serbia, certain issues have remained unresolved, or were regulated too broadly, which left room for arbitrary interpretation. The following were the most common practical issues that occurred in the course of preparation of corporate profit tax returns:
  - classification of certain assets for tax depreciation purposes
  - tax depreciation base for immovable assets held on 31 December 2003
  - lack of definition of impairment of assets for corporate profit tax purposes gives additional uncertainty related to deductibility of inventory provisioning

**Deferred tax**

- Deferred tax assets and liabilities can arise on the basis of the following:
  - tax credit for investment in fixed assets that can be carried forward for the subsequent ten years
  - difference between carrying value of assets in accounting records and tax value of assets available for tax depreciation in future years
  - tax losses that can be carried forward for ten years

The Serbian Corporate Income Tax Law is still rather unsophisticated and, thus, there are still uncertainties in respect of treatment of some items from the deferred tax prospective.
Indirect taxation

VAT

• The government proposed changes to the VAT Law, and submitted them to Parliament on 1 June 2005. The amendments are currently being discussed in Parliament. The most significant changes are:

Extending the lists of goods and services taxable at 8% to, among others:

– first transfer of rights on new buildings that will be used for housing needs, under the condition that the purpose of the building is not changed within a five-year period
– all medications including medications for animals
– tickets for movies and theatres, fairs, circuses, parks, concerts, exhibits, sports performances, museums and galleries, botanic gardens and zoos, etc.

Extending the existing list of tax exemption on imports to, among others:

– exported goods returned to Serbia because the quality of goods did not meet requirements stipulated by the relevant agreement
– goods imported into duty-free shops
– products imported on the basis of donation agreements signed with Governments (Serbian, and Serbian and Montenegrin Government) when tax exemption is provided by those agreements
– devices for disabled persons except for vehicles

Extending the tax exemption list without the right to deduct input VAT to:

– renting out land
– services on assessment of natural person and legal entity credit capacity

Extending the tax exemption list with the right to deduct input VAT to:

– goods dispatched to duty free shops located at airports
– goods dispatched from duty free shops
– goods and services supplied on the basis of donation agreements signed with Governments when tax exemption is provided by those agreements

Refund

– The refund of tax paid is now also available to health care institutions under certain conditions, and to traditional churches and religious communities.

Double Tax Relief

– Supply of cars, motor cycles, ships and aircraft for which input VAT could not be reclaimed when these were purchased is not to be considered as a supply for VAT purposes.
– Replacement of goods under warranty is not considered a supply of goods.

Records

– The taxpayer is obliged to keep VAT evidence for at least ten years.

Customs duties

• The Serbian Government proposed changes to the Custom Tariffs Act and the Customs Act in May 2005. The most significant proposed amendments are the following:

– increased number of tariff groups
– changes of customs rates towards compliance with EU standard HSC1000/2002
– increase of customs rates for 175 end-consumption products
– reduction of customs rates for 162 end-consumption products
– the right of Government to intervene by changing or abolishing customs rates in cases of market distortion

Excise duties

• The Parliament adopted the Act on Amendments to the Excise Duty Act (published in Official Gazette No. 46/05, 2 Jun 2005). The Act is applicable as from 3 June 2005. The most significant changes are:

– The Serbian government has the right to increase/decrease excise duty on oil derivates within a 20% range, depending on the crude oil price variations.

– An excise tax has been introduced on oil derivates in 380 °C distillation range.

– Excise duty exemption is given for products that are sold in duty free shops located in airports.

– A minimum excise duty for cigarettes and tobacco products has been introduced and defined at certain rates proportionate to prices of the most popular cigarette and tobacco products.

– An excise duty on cigars, cigarillos and smoking tobacco has been defined for the next five years, in a range of 30% to 50% of the retail price per kilo.

The advantages of these changes are that they: maintain the existing price level of oil derivatives on the market; suppress malpractice and the “grey economy” in oil derivates trade; restrict low quality tobacco imports and protect the domestic industry.
Individual taxation

Social security

- The maximum annual tax base for 2005 has been recently published: CSD 1,425,448 (approximately EUR 17,400).

- New incentives were introduced in Serbia for employers to hire employees older than a certain age who have been registered at the National employment service as unemployed for at least a year. Using this incentive, an employer can decrease its taxable base partially or, in some cases down to zero.

Legal and other developments

Business transformations

- Legislation amending the Privatisation Act came into force on 7 June 2005. In general, the new legislation regulates the privatisation procedure in more detail, provides for greater efficiency of the process by imposing deadlines for certain actions and introduces new provisions aimed mainly at speeding up the privatisation process and ensuring that the course of action after privatisation is in line with the requirements of the share purchase agreement (SPA).

The key innovations introduced are the following:

- Wider competencies of the Agency for Privatisation – The Agency for Privatisation (the Agency) may be appointed as a receiver in a bankruptcy procedure initiated against companies with majority state or social capital. The control function exercised by the Agency in the process of privatisation is regulated in more detail.

- Restricted buyers – The list of persons who cannot be buyers in the privatisation process is more clearly determined. It includes a domestic legal person with majority state ownership, a person or the founder of a legal person who already has due obligations towards the object of privatisation, and a person with whom an SPA was terminated as a result of breach of contractual obligations.

- Rights and duties of participants in the public auction – The amendment prescribes sanctions for participants in a public auction who fail to sign the minutes of the auction or make payment of the price within deadline. Such a participant is not allowed to participate in future auctions of the same object of privatisation, has no right to request return of the deposit, and is obliged to pay damages in the prescribed amount. A person who lost the right to be a buyer is not allowed to participate in future auctions of other objects of privatisation within a period of six months. Prohibition of participation is extended to the participant’s family members.

- Methods of restructuring – Restructuring in privatisation includes changes related to the object of privatisation and its subsidiaries which enable the sale of its assets, and particularly:
  - status changes, changes of legal form, changes of internal organisation and other organisational changes
  - full or partial write off of the principal debt, related interest or other claims
  - remission of a debt, fully or partially, for the purpose of repayment of debts towards creditors from funds raised through the sale of a company’s assets

- Restructuring/privatisation programme – Before developing a restructuring programme, an overall analysis of the object of privatisation has to be undertaken. The Agency approves the restructuring programme.

The identified responsible person in the privatisation is liable for any inaccuracy or incompleteness of data in the privatisation programme and for any damage resulting from the statement (of truth accuracy and completeness) in the privatisation programme documentation, if given with malicious intent or with gross negligence.

- State creditors – State creditors are obliged to write off in full their receivables towards the object of privatisation and are then entitled to be repaid from the funds raised from the sales of capital/assets of the object of privatisation by public tender. In some cases, the Agency for Deposit Insurance, Bankruptcy and Liquidation of Banks has the capacity of a state creditor. Other creditors may, but are not obliged, to act similarly towards the object of privatisation.

- Termination of the SPA – An SPA is deemed terminated not only if the buyer fails to pay the price, but also in some other cases such as failure to invest in the object of privatisation, failure to deal with employment issues in the fashion stipulated in the SPA and in other cases representing breach of obligations stipulated in the SPA. If the agreement is terminated, the price paid is not returned to the buyer, and the capital sold by signing the SPA is transferred to the Share Fund.

- Temporary representative of the capital – If an SPA is terminated, the Share Fund appoints a temporary representative of the capital to manage the object of privatisation until the capital/assets of the object of privatisation is finally sold. The Law regulates the obligations and liability for damages of the temporary representative.

- Transfer of the SPA – Upon obtaining consent from the Agency, the buyer (transferee) may transfer the SPA to another entity (transferor) provided that the transferor fulfills conditions prescribed for the buyer of the capital or assets of the specific company in privatisation. The transferee guarantees that the transferor will fulfil the obligations arising from the SPA.
New assessment base for social security contributions

The employer and employee maximum social security contributions in Slovakia are calculated from an assessment base that is changed once a year by the Ministry of Social Affairs.

The Ministry has announced the general assessment base for social insurance contributions for the period from 1 July 2005 to 30 June 2006. The new general assessment base is SKK 189,900 (around EUR 4,840), which is 12 times the official average monthly salary in Slovakia for 2004. The monthly maximum assessment bases for social insurance contributions are derived from this amount.

This means that, from 1 July 2005 to 30 June 2006, the maximum monthly assessment base for sickness and guaranteed insurance contributions will be SKK 23,738 (around EUR 600). The maximum monthly base for retirement, permanent disability, unemployment, and reserve fund contributions will be SKK 47,475 (around EUR 1,210).

The maximum assessment base on which monthly health insurance contributions are calculated will be SKK 47,475 (around EUR 1,210).

The maximum employee and employer contributions in SKK (EUR 1 = SKK 39,2) for the period from 1 July 2005 to 30 June 2006 are illustrated in the table below.

<table>
<thead>
<tr>
<th></th>
<th>Employee</th>
<th>Employer</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rates</td>
<td>Max. contribution (SKK)</td>
</tr>
<tr>
<td>Sickness</td>
<td>1.4%</td>
<td>333</td>
</tr>
<tr>
<td>Retirement</td>
<td>4%</td>
<td>1,899</td>
</tr>
<tr>
<td>Permanent disability</td>
<td>3%</td>
<td>1,425</td>
</tr>
<tr>
<td>Unemployment</td>
<td>1%</td>
<td>475</td>
</tr>
<tr>
<td>Health</td>
<td>4%</td>
<td>1,899</td>
</tr>
<tr>
<td>Guaranteed fund</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Reserve fund</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Total</td>
<td>13.4%</td>
<td>6,031</td>
</tr>
</tbody>
</table>

For comparison, the maximum contributions for the period to 30 June 2005 are SKK 5,474 (around EUR 140) for the employee’s contributions, and SKK 14,472 (around EUR 370) for the employer’s contributions.

The employer is also obliged to pay injury insurance contributions. The applicable percentage depends on the employer’s safety classification. However until 31 December 2006, this percentage is levied at a flat rate for every employer, which is 0.8% of employees’ total taxable employment income, with no maximum limit.

Individual taxation

Social security

- From 1 July 2005 to 30 June 2006 the maximum remuneration on which any social contributions are calculated will be SKK 47,475 (around EUR 1,210).
- Statutory representatives of Slovak limited liability companies (S.R.O.’s) are liable to pay health insurance contributions as if they were self-employed. However from 1 August 2005, statutory representatives should be treated as regular employees for health insurance purposes.
Dividend distribution from a Slovene to an EU-based company

The new Act on Corporate Income Tax (CIT Act) makes dividends distributed by a Slovene resident company to a non-resident subject to a 25% withholding tax.

Article 69 of the new CIT Act summarises provisions of the EU Parent-Subsidiary Directive and designates dividends, however, as exempt:

– if the company recipient of the dividends owns more than 20% of its shares or exercises more than 20% of its voting rights, and this relationship existed at least 24 months before the dividend was paid (the period is not an absolute period, as the tax payer can fulfill this criterion by giving a bank guarantee to the Tax authorities to secure the tax liability), and

– the beneficiary of the dividend distribution is an EU company to which the common taxation system is applied, a resident of the EU for tax purposes (as defined in Annex 5 to the Regulations to the Slovene CIT Act), a taxpayer of one of the taxes for which the common system of taxation is used, as defined by the Ministry of Finance, and is not a company exempt from corporate income tax nor does it have the possibility of opting for a lower rate than the minimum (as defined in the Annex 6 to the Regulations to the Slovene CIT Act)

The Tax Procedure Act defines the procedure to be followed and the documentation that a company should provide to the Slovene Tax Authorities in order to be able to apply the exemption using provisions of the directive which consists of:

– the certificate of tax residency of the receiving company at the date of dividend’s payment
– the certificate proving that at the date of dividend’s payment the receiving company had predefined organisational form and that it is subject to the corporate income tax
– the certificate proving the minimum capital requirement of 20% and minimum holding period of 24 months

According to the informal opinion of Slovene tax authorities, the documentation necessary in order to be able to apply the exemption is:

– certificate of tax residency of the receiving company issued by the reference tax authorities, which should also include the status of the parent company – usually it is known to the reference tax authorities
– certificate that the receiving company was at a time of actual payment organised in a predefined form and is subject to the corporate income tax
– the certificate proving the minimum capital requirement of 20% and minimum holding period of 24 months has to be obtained by the paying company (i.e. excerpt from the company register with the Slovene court, which should not be dated any earlier than the date of the actual payment)

According to the Slovene Tax Procedure Act all requested documentation, proving that withholding tax does not have to be paid, has to be submitted to the tax authorities no later then 15 days after the day of the actual payment of the dividend.
Corporate taxation

Corporate tax

- The deduction for voluntary insurance expenses (except for expenses on medical and pension insurance) is limited to 5% of gross deductible expenses for the reporting period.

- When computing tax on net premium, insurers can deduct amounts actually paid to re-insurers (previously deduction for the cost of re-insurance was available on accrual basis).

- The definition of fixed assets of Group 4 (computers and other IT items) has been modified: the cost of any software should be depreciated at the depreciation rates applicable to Group 4 of fixed assets (previously it was understood that Group 4 depreciation rates were applicable to pre-installed software).

- The limit for doubtful/bad debt reserves that banks and financial institutions can deduct has been reduced to 10% (previously 20%) for banks and 15% (previously 30%) for non-banking financial institutions, of the total value of debt claims on the last business day of the reporting period.

- Application of the single tax regime has been restricted with effect from 1 July 2005 for the following activities:
  - trade with drugs and medical goods
  - architecture
  - legal services
  - audit services
  - renting out of real estate
  - real estate agency

Investment incentives

- Law No. 2505 has cancelled special tax and investment regimes in 16 Special Economic Zones for both existing and new investments and tax benefits previously granted to certain industries such as automotive and shipbuilding.
Indirect taxation

VAT

• According to the amended definition of the tax base, VAT should be computed based on contractual value, which cannot be lower than the "customary" (i.e. fair market) price of goods or services. The new definition gives to the tax authorities the right to adjust VAT liabilities for any transactions if they can prove that the contractual price is lower than the market price for goods or services.

• As a result of an amendment to the VAT Law, the sale of stock in a limited liability company qualifies for VAT exemption.

• VAT exemption for contribution of fixed assets to the capital of a legal entity and return of such contribution has been cancelled.

• The amount of interest under a financial leasing contract that is exempt from VAT has been limited to twice the interest rate (prime rate) of the National Bank of Ukraine.

• Services for transit of cargo and passengers through the territory and ports of Ukraine have been added to the list of VAT-exempt transactions.

• The amended law allows recovery of input VAT without the supplier’s VAT bill in the following cases:
  – purchase of goods or services paid for in cash or by payment card, within limits established by the National Bank of Ukraine (currently the limit for cash settlements is UAH 10,000, approximately EUR 1,600 per day)
  – purchase of transport tickets
  – settlement of hotel bills
  – settlement of invoice for telecommunication services and other services for which the value of services is determined based on the data of a measuring device (e.g. electricity)
  – purchase of sundry goods (services) in the amount of UAH 200 (approximately EUR 30) per day

• Input VAT on the purchase of cars for use in the taxpayer’s business (except for cars to be used as taxis) cannot be recovered as a credit. However, such input VAT can be included in deductible expenses for corporate profits tax purposes.

• The following persons cannot apply for VAT refund:
  – a person who has been registered as a VAT payer for less than 12 months prior to applying for the refund and/or whose volume of VAT-able transactions for the last 12 months is less than the amount of VAT claimed for refund, except for VAT credit in connection with the purchase or construction of fixed assets
  – a person who has not conducted business for the previous 12 months

• People that use simplified tax regime or are relieved from the obligation to pay VAT

• The restriction preventing enterprises with foreign investments from paying import VAT by promissory note has been removed. Promissory notes cannot be used to pay for excisable goods or goods classified under commodity headings 1-24. They also cannot be used by persons who were registered as a VAT payer less than 12 months prior to the date of import, or persons who do not qualify as VAT payers at standard rates. Promissory notes must be secured by a bank.

• Zero VAT applies to international transport services. However, due to a change in the definition of international transport services, zero VAT can apply only in relation to transport to/from customs check points (previously zero VAT applied in relation to transportation to/from place of customs clearance). Thus, carriers will need to apply 20% to transport services between points of inland customs to/from customs check points at the border.

Individual taxation

Personal income tax

• An amendment to the Personal Income Tax Law, effective from 31 March 2005, says entrepreneur’s fees should be treated as employment income if the entrepreneur-payer of single tax renders services to other persons for a period longer than one calendar month during fiscal year, and such income should be taxed accordingly.

• The exemption from tax for income from the sale of real estate has been extended to 1 January 2006.

Social security

• Effective from 31 March 2005 the rate of employer’s contributions to the State Pension fund has been increased to 32.3% (from 32%) and, simultaneously, the deduction rate for the Unemployment Fund has been reduced from 2.9% to 2.6%. Thus, the total tax cost for the employer remains the same. The cap for the tax base remains UAH 4,100 (approximately EUR 660) per employee per month (the cap is effective from 1 January 2005).

Other taxes

Other

• Law No. 2505 introduced changes in respect of:
  – tax on owners of transport vehicles
  – excise tax (applicable to tobacco products, cars, fuel, alcohol, beer)
  – land tax
Attraction of direct private foreign investment

The new Decree of the President of the Republic of Uzbekistan of 11 April 2005 on Further Measures for Facilitating Attraction of Direct Private Foreign Investments (the Decree) was issued on 11 April 2005.

Ten-year guarantee

The Decree clarifies the application of the following ten-year guarantee against adverse changes in legislation provided in Law of the Republic of Uzbekistan on Guarantees and Measures for Protection of Rights of Foreign Investors #611-I of 30 April 1998 (Article 3, Paragraph 4):

“In the event that the subsequent legislation of the Republic of Uzbekistan negatively affects investment conditions, the investments are subject to legislation effective at the date of investment for ten years from the date of investment. Foreign investors at their own discretion, have the right to apply those provisions of the new legislation, which positively affect investment conditions.”

The Decree states that the guarantee is applicable only in the cases listed below:

– Increase of the income (withholding) tax rate on dividends payable to foreign investors
– Introduction of additional requirements that (i) complicate the procedure for repatriation or (ii) decrease the amount of income (profit) repatriated by foreign investors, except for certain cases in which such repatriation is banned due to financial insolvency of enterprises with foreign investments, protection of creditors’ rights, criminal or administrative sanctions imposed on individual foreign investors
– Introduction of limitations on the size of investment, including an increase of the minimum size of charter capital for enterprises with foreign investments
– Introduction of limitations on the stakes of foreign investors in charter capital in Uzbek enterprises
– Introduction of additional procedures for visas for foreign investors, as well as other additional requirements on foreign investment

The Cabinet of Ministers of the Republic of Uzbekistan is expected to approve a Regulation on the above matters soon.

Corporate taxation

Investment incentives

• In accordance with the Decree, certain tax incentives are offered to private foreign investors effective 1 July 2005. Enterprises attracting private foreign investments are exempt from income (profits) tax, property tax, infrastructure development tax, ecology tax, unified tax for micro-firms and small enterprises, as well as contributions to the Republican Road Fund. Exemption is applicable to the main business activity only.

The above tax incentives are available for different periods depending on the size of direct private foreign investment:

<table>
<thead>
<tr>
<th>Investment value (USD)</th>
<th>Incentive period</th>
</tr>
</thead>
<tbody>
<tr>
<td>300,000 – 3,000,000</td>
<td>3 years</td>
</tr>
<tr>
<td>3,000,000 – 10,000,000</td>
<td>5 years</td>
</tr>
<tr>
<td>10,000,000 –</td>
<td>7 years</td>
</tr>
</tbody>
</table>

The above tax incentives are granted if the following conditions are met:

– The enterprises are located in the labour surplus regions (Karakalpakstan, Dzhizak, Kashkadarya, Syrdarya, Surhandarya, Khorezm), as well as in rural areas of Navoi, Andijan, Namangan and Ferghana regions.
– The Republic of Uzbekistan does not provide sovereign guarantees for such foreign investment.
– Share of foreign capital in enterprises should not be less than 50%.
– Investment should be made after the state registration of the above enterprises (not very clear requirement).
– Investment should be made in hard currency or new/modern technological equipment.
– Respective tax savings should be reinvested for further development of enterprises.

The Decree also contains additional benefit clauses, as below:

– Interest on long-term loans attracted by enterprises with foreign investments with no sovereign guarantee of the Republic of Uzbekistan is deductible for income (profits) tax purposes.
– Losses on the main activity in newly established enterprises with foreign investments may be carried forward for five years. However, the wording in the Decree is unclear on the exact procedure for implementation of this option.
– In the event of any subsequent adverse legislative changes to the investment conditions, the above tax incentives are applicable to the entire period originally granted.

We suggest that ‘direct private foreign investment’ implies any direct foreign investment that does not belong to foreign states. However, the risk exists that ‘private’ may be interpreted as originating from a natural person only, therefore, further clarification should be sought before making any decision on utilisation of the exemptions.