

# CEE Tax Notes

Working cross-border\*

Issue No. 8/2  
First Electronic Update

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# Editor's foreword

Although it is almost the middle of the summer, the legislators are still busy fine-tuning the 1 January changes. Some of them have already passed amendments which will enter into force from 1 January 2009. The quiet summer months offer an opportunity to digest the interpretation of the previous changes and prepare for the future ones.

Three of the countries in the region have made significant steps towards regional and global economic integration. Serbia in April and Bosnia and Herzegovina in June signed the Stabilisation and Association Agreement with the European Union, and Ukraine became a member of the World Trade Organisation in May.

As usual, a lot of tax and legal developments have taken place in the region in the first few months of the year. Bosnia and Herzegovina report progress on the elimination of double taxation within the state. Macedonia has introduced a new law on concessions and public-private partnerships. The Estonian Parliament has already passed corporate income tax changes which will come into effect on 1 January 2009. The Polish government aims at luring back Poles currently living abroad by implementing the concept of a "friendly state".

Please note that this publication is designed solely for information purposes. Rules and regulations are described in brief and general terms only and should not be regarded as a substitute for professional advice.



# Albania

## Recent VAT changes

### VAT deferral scheme

The VAT on machinery and equipment imported by Albanian registered entities for any type of business activity is now subject to the VAT deferral scheme, under which the payment of the VAT is deferred for up to 12 months.

### VAT deduction on fuel purchases

The taxpayer has the right to deduct VAT if the fuel is used solely for technological purposes. The liability to provide evidence to the tax authorities that the fuel is used only for technological purposes rests with the taxpayer.

The taxpayer must notify the General Tax Directorate (GTD) in writing about the VAT deduction and submit the required supporting documents. If the documentation is incomplete or false, the GTD is entitled to conduct a tax audit of the taxpayer, suspend the right to deduct the VAT for one year and, if necessary, impose related penalties.



### VAT exemption on supplies by non-profit organisations

Supplies made by non-profit organizations are VAT-exempt if they meet the following criteria:

- the services are offered by religious or philosophical organisations for the purpose of spiritual welfare; and
- the organisation makes the above supplies for a reduced payment.

If these criteria are not met, and if the non-profit organisation's annual turnover exceeds ALL 8 million (approx. EUR 65,700), the organisation is required to register for VAT.

The above VAT law amendments came into effect in February 2008.

## Corporate taxation

### Corporate tax

- From 1 January 2008, wholesalers whose annual sales turnover is below ALL 8 million (approx. EUR 65,700) (small businesses) are not obliged to register for VAT purposes and are subject to a 10% corporate tax rate. The taxable base is calculated as the difference between their annual revenue and annual deductible expenses.

### Double Tax Treaties

- Albania is party to 25 Double Tax Treaties. A new tax treaty has been concluded with Austria.

## Individual taxation

### Tax on transfer of ownership

- The tax rate on income derived by individuals from the transfer of ownership of real estate (land and/or buildings), is now 10% of the net income. The tax on the income is payable on the difference between the sale price and the purchase price of the real estate. However, the sale price cannot be lower than the minimum value stated by law. The same value applies in case of donations. The amendment came into effect on 1 January 2008.

## Legal and other developments

### Other

- From 1 January 2008, the minimum wage for employees is ALL 16,000 (approx. EUR 130).

# Armenia

## Tax legislation codification

The government of Armenia is planning to codify the tax legislation by asking the National Assembly to adopt a Tax Code. The Tax Code in draft form is already at the discussion stage by the National Assembly Permanent

Commission. At present, no date has been given for presenting the text to Parliament.

Currently, Armenian tax legislation is not codified, and consists of a series of separate laws.



# Azerbaijan

## Introduction of VAT deposit account

In the last 12 months, Azerbaijan has stepped up its efforts to combat VAT fraud, which has become widespread.

As a major step in tightening control over VAT compliance, a new VAT payment method has been introduced, effective from 1 January 2008.

Now all VAT-registered taxpayers are required to pay vendor invoices in two instalments:

- the price of the purchased goods or services (without VAT) is paid to the vendor's commercial bank account; and
- input VAT is remitted to a special "VAT deposit account", which is a treasury account for collecting and recording VAT payments to the State Budget.

Input VAT paid to any other account (i.e. not the VAT deposit account) will not be allowable for claims in taxpayers' VAT returns.

Vendors must include the details of the VAT deposit account in their VAT invoices as well as the vendor's details, including the vendor's Tax ID.

All input VAT amounts that customers pay into the VAT deposit account are recorded on individual virtual "sub-accounts" of the vendor. The vendor may transfer the VAT amounts accumulated on their individual sub-accounts for payments of VAT charged by their own vendors or other tax liabilities to the Budget.

For transfers of funds from the sub-account, the taxpayer needs to have access to the "Internet Tax Department". The taxpayer should apply to the tax office to obtain an ID, a code and a password (free of charge).

The new VAT payment system has not been welcomed by local and foreign businesses, due to the concern about the increased strictness of tax compliance and the extra administrative burden (two remittances for each invoice, etc.). However, some taxpayers think that the new system has its advantages specifically that it allows them to access their VAT records and balances on-line through the internet.

However, as with any newly established mechanism, the practical implications for and effects on business are yet to be seen.

## Corporate taxation

### Corporate tax

- A number of amendments have been made to the Tax Code, effective from 1 January 2008.
- The rates of financial sanctions for the understatement or underpayment of taxes has increased from 25% to 50% of the unreported or unpaid tax.
- Taxpayers that open bank accounts at overseas banks are required to obtain permission from the tax authorities. Receiving proceeds into an overseas bank account without such permission is subject to a financial sanction of 100% of the proceeds received into such account.

### Double Tax Treaties

- As of 1 March 2008, Azerbaijan has 25 Double Tax Treaties in force. The most recent treaty is with Qatar and was ratified by Parliament on 19 October 2007.

## Indirect taxation

### VAT

- The Cabinet of Ministers has added some new items to the list of goods that are exempt from import VAT, including:
  - baby food, medicines, materials for kidney dialysis, wheelchairs;
  - paper for newspapers, books, magazines, postal stamps, state stamps, etc.;
  - aluminium ore, electricity, wind-powered electricity generation equipment;
  - signal flares, hand guns and other military ammunition.
- The Cabinet of Ministers has set new ratios for cities and towns, for companies involved in the construction of residential buildings to calculate their minimum turnover for VAT registration purposes.

## Individual taxation

### Social security

- A number of amendments to the Law on Social Insurance took effect on 1 January 2008.

- Some of the main changes to the Law on Social Insurance are:
  - The concealment of a number of employees (absence of employment contracts) is subject to a penalty of approx. EUR 42;
  - Social insurance contributions paid by natural persons engaged in trade or construction activities are reduced from 70% to 50% of the national minimum monthly wage (currently, the minimum monthly wage is approx. EUR 47);
  - Social insurance contributions paid by all other natural persons engaged in entrepreneurial activities are reduced from 40% to 20% of the national minimum monthly wage.
- For example, while the previous law permitted foreign natural persons to establish insurance companies jointly with Azeri persons, according to the new law, foreign natural persons are now barred from being shareholders or founders of insurance companies.
- The latest law stipulates that a number of clauses will be introduced in stages. For instance, the clauses on insurance agents should become applicable one year after the date when the Law came into effect.

## Legal and other developments

### Labour code

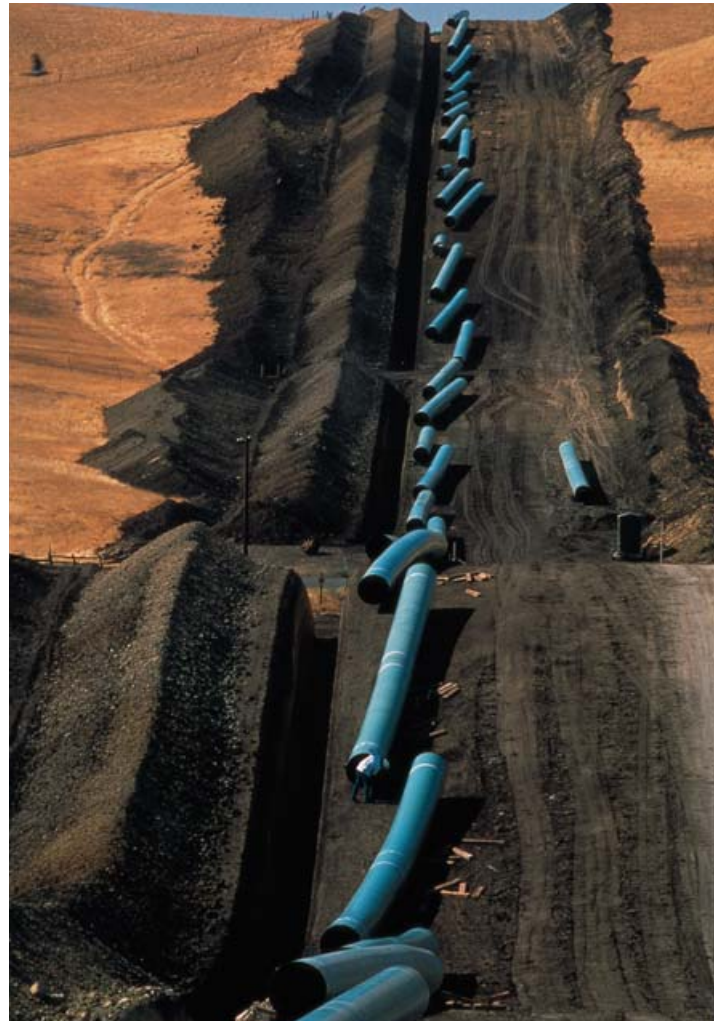
- From 1 January 2008, the minimum monthly wage and statutory basis for calculating employment pensions has increased from approx. EUR 39 to approx. EUR 47.
- The amendments regarding breaches of the labour regulations have been introduced into the Administrative Infringements Code.
- Employers who hire natural persons without an employment contract and create “conditions for concealing income” are liable to a penalty of approx. EUR 782 per employee.
- Hiring foreign employees without work permits is subject to a fine of over EUR 30,000 per employee. Previously, the legislation did not include a fine for this default, and the only penalty was that the employee should be deported at the employer’s expense.
- Other penalties for various violations of the labour laws have also been increased, such as, for example, compensation for employees paid below the statutory minimum or whose employment contract is termination unlawfully.

### New insurance law

- On 16 March 2008, a new Law on Insurance activity was published in the official gazette. A number of changes regarding insurance activity have been introduced.

### New business trip limits

- New minimum per-diems for business trips within Azerbaijan and overseas have been published by the Cabinet of Ministers. The new per-diems are lump-sum amounts covering the daily expenses such as food hotel, telecommunications, in-country transportation (excluding taxi fares) costs, and expenses related to other services, thus replacing the previous separate payments for food, hotel, transportation, etc. costs.



# Bosnia and Herzegovina

Please note that the state of Bosnia and Herzegovina (further referred to as “SBIH”) consists of two entities: the Federation of Bosnia and Herzegovina (further referred to as “FBiH”) and the Republika Srpska (further referred to as “RS”).

## Elimination of double taxation

The new FBiH Corporate Income Tax Law was introduced on 1 January 2008. This law contains an article which represents the unilateral initiative of the FBiH Tax Authorities not to tax companies founded in the RS on income obtained from doing business in FBiH. This is a huge step forward which removes what was potentially a significant barrier to doing business in SBIH, i.e. the double taxation issue relating to the corporate tax legislation of the two state entities.

Prior to the new FBiH corporate income tax legislation, no relief was granted for tax that an RS business incurred in FBiH, or by an FBiH business in RS. This was a disincentive for businesses to expand. The new FBiH corporate income tax law prescribes that the “taxpayer – a business unit of a non-resident that is established or whose head office or whose operational office or place where the monitoring of the business unit takes place is outside FBiH but in SBIH – is relieved from corporate income tax that its business incurred in FBiH”.

It is anticipated that this will encourage the RS Tax Authorities to reciprocate and to grant tax relief on income that FBiH-founded companies obtain in RS. This would completely eliminate double taxation between entities in SBIH and create a positive environment for economic expansion. However, for the moment, any taxes attributable to the activities of an FBiH company in RS, are taxable in RS and then a deduction for any tax paid is given in FBiH.

## Corporate taxation

### Withholding tax

- In FBiH the general withholding tax rate is 10%. However, dividends are taxed at only 5%. The tax base for withholding tax is the gross amount that a resident person pays to a non resident person in the form of:
  - dividends, royalties interest, and other rights of intellectual ownership;
  - fees for market research, tax consultancy, audit services;
  - fees for recreational and sports events;
  - insurance and reinsurance premiums;
  - fees for telecommunications services between FBiH and another state, etc.

## Double Tax Treaties

- Recently SBIH signed a Double Tax Treaty with Spain.
- SBIH is not an OECD Member State.

## Investment incentives

- The FBiH Corporate Income Tax law prescribes the following tax incentives:
  - A taxpayer whose income from exports was more than 30% of its total income in the year it was established is exempt from corporate income tax for that year.
  - A taxpayer that has invested a minimum of BAM 20 million (approx. EUR 10.2 million) in production in FBiH over five consecutive years is exempt from taxation for that period of five years, starting with the first year in which it invested at least BAM 4 million (approx. EUR 2 million).
  - A taxpayer that employs people with disabilities or other special needs as more than 50% of its workforce for more than one year, is exempt from corporate income tax for that year.
  - A taxpayer that is a business unit of a non-resident company that is established or whose head office or operational office or place where the monitoring of the business unit takes place is outside FBiH but in Bosnia and Herzegovina, is exempt from corporate income tax that its business incurred in FBiH.
- A taxpayer that invests in machinery and equipment in RS for use in its own registered production activity will have its tax base reduced by the amount of the investment (this incentive is valid until 31 December 2008).

## Indirect taxation

### Customs duties

- In SBIH, the customs duties rates are 0%, 5%, 10% and 15%, depending on the customs tariff of the goods.
- In 2007, SBIH ratified CEFTA (the Central European Free Trade Agreement). CEFTA replaced 32 bilateral agreements. States which are also members of CEFTA are Croatia, Macedonia, Moldova, Montenegro and Serbia.
- SBIH is in the final phase of joining the WTO.

## Individual taxation

### Personal income tax

- The new Personal Income Tax Law is now progressing through Parliament. It will introduce progressive tax rates, from 10% to 15%. The new law will replace the existing dual system of annual personal income tax at the level of the cantons, and wage tax.

# Bulgaria

## New visa regulations

Parliament has passed a new Regulation on the structure of the visa regime and the conditions for issuing visas, which will enter into force on 10 July 2008 and will repeal the regulation on the conditions for issuing visas which is currently in force.

The new regulation includes the following changes:

### Short-term visa C

Multiple-entry short-term visa C can now be issued to foreigners who are members of the family of a Bulgarian citizen, a citizen of an EU/EEA member state or Switzerland who has been issued with a certificate for long-term residence in Bulgaria, or a foreigner who has been issued with a long-term residence permit in Bulgaria.

Previously, short-term visa C was issued for one, two or multiple entries to Bulgaria for a total period of stay of up to 90 days within a six-month period. With the new regulation, under certain conditions visa C can be issued for a stay of up to 90 days within one year, and up to 90 days within up to five years under exceptional circumstances.

The regulation introduces new requirements for the documents that must accompany visa C applications:

- Previously, the inviter's permanent address had to be certified by the municipality in the case of an invitation for a private trip, and by the Bulgarian Chamber of

Commerce and Industry in the case of an invitation for a business trip. Under the new rules, the invitation letter needs to be notarised, and also certified by the Bulgarian immigration authorities.

- A new requirement for foreigners is that they have to present an insurance policy with minimum cover of EUR 30,000, issued by a licensed insurance company operating in the EU.

### Long-term visa D

Long-term visa D gives a foreigner the right to multiple entry and residence in Bulgaria while the foreigner is waiting for a residence permit. Previously, visa D entitled a foreigner to reside in Bulgaria for up to 90 days within a six-month period. The new Regulation allows a foreigner a stay of 180 days within a six-month period.

Visa D applications should be filed with the Consular Office of the Bulgarian Embassy in the country where the applicant is permanently resident. Previously, the application could be filed at any Bulgarian Consular Office abroad.

The procedure for issuing a visa D now includes a mandatory interview with the applicant in person, which is scheduled by the consular official when the application is submitted.

When applying for a visa D, the foreigner should enclose an insurance policy with minimum cover of EUR 30,000, issued by an EU-licensed insurance company.



# Croatia

## Implementation of incentives for the employment of disabled people

On 16 January 2008, a new decision on incentives for the employment of disabled people came into force, introducing the types of incentives and the methods of calculating them.

Incentives for employers of disabled people and self-employed disabled people are divided into regular and special incentives. This new decision contains the same incentives as the old one but with more specific definitions, and allocates them according to purpose. The incentive base is determined without regard to the disabled persons' salary level.

## Corporate taxation

### Double Tax Treaties

- The Double Tax Treaty with Israel came into effect on 1 January 2008. The withholding tax rates on dividends are 5% if the recipient is the beneficial owner, i.e. a company (partnerships excluded) which directly holds at least 25% of the capital and/or voting power of the company paying the dividends, 10% in cases specified in the Double Tax Treaty, or 15% if the recipient of the dividends is the beneficial owner. The rate on interest payments is 5% in cases specified in the Double Tax Treaty, or 10% provided that the recipient of the interest payment is the beneficial owner. The tax rate on royalties is 5% provided that the recipient of royalties is the beneficial owner.

### Investment incentives

- A Resolution on the promulgation of the Law on State Support for Education and Training provides that:
  - small and middle-sized companies are entitled to decrease their corporate income tax base by up to 70% of the costs of their employees' general education and by up to 35% of the costs of education specifically related to their work.
  - large entrepreneurs are entitled to decrease their corporate income tax base by up to 50% of the costs of their employees' general education and by up to 25% of the costs of education specifically related to their work.
  - beneficiaries of state support that meet the conditions for regional state support can increase the amounts prescribed for small and middle-sized companies (70%, 35%) and large entrepreneurs (50%, 25%) by an additional 10%, provided that the services are performed in Area A (confirmed by the regional state support map), and/or 5% provided that the services are performed in Area B (confirmed by the regional state support map).

- General education means education of employees that is not directly or necessarily intended for the purpose of their present or future workplace. It provides the employee with qualifications that he or she will be able to use at another workplace or for a different type of work, or which gives the employee better opportunities for future employment.
- Special education means education that is directly or necessarily intended for the purpose of the employee's present or the future workplace. It provides the employee with qualifications that he or she will either not be able to use at another workplace or for a different type of work, or will only partly be able to use.

## Indirect taxation

### VAT

- On 26 March 2008, the new Regulation on Modifications and Amendments to the VAT Regulations came into force, introducing new customs duty and tax relief on financial aid from the European Union.
- The VAT Regulations set tax relief rates for the provision of goods and services abroad when this is stated in the international agreement which is binding on the Republic of Croatia. There is a wider range of customs duty and tax relief, and special tax and VAT relief for project beneficiaries who have received financial aid from the European Union for the purchase of goods and services from abroad or inland.

## Individual taxation

### Social security

- Croatia has signed social security conventions with over 20 countries. Exemption from social security payments in Croatia is possible if the individual is contributing/liable to the foreign social security system of a country with which Croatia has signed a social security convention. The individual needs to be entitled to exemption under the social security convention and to be able to obtain the required certificate.

## Legal and other developments

### Accounting act

- The Ministry of Finance issued an opinion on 1 February 2008 concerning the new structure of annual reports which is regulated by the new Accounting Act, stating that the financial reports for 2007 will be drawn up according to the Accounting Act for 2005, and published in accordance with the Annual Financial Report Act and other by-laws.

# Czech Republic

## Cancellation of investment incentives

In April, the Czech government approved a proposal to end investment incentives for the manufacturing industry. The incentives include tax holidays, job creation subsidies, and training and retraining subsidies.

Incentives already granted will remain valid but starting next year no new ones will be granted. We therefore recommend to companies to evaluate their investment plans for the next three years and assess whether to make use of the last chance to obtain investment incentives.

The basic conditions for being granted investment incentives are as follows:

- an investment of at least CZK 100 million (approx. EUR 3.8 million) in the expansion of production over the next three years (the minimum investment is reduced to CZK 50 million, approx. EUR 1.9 million or, as the case may be, CZK 60 million, approx. EUR 2.3 million, for regions with high unemployment);
- financing at least half of the minimum investment using own equity; and
- at least 60% of the total investment must be used to buy new machinery.

In the future, the following areas will continue to be eligible for support:

- research and development (tax allowance for research and development),
- construction and expansion of technological centres and strategic service centres that provide support services for industrial enterprises.

Additionally, it will continue to be possible to make use of a broad range of assistance from the European structural funds.

## Individual taxation

### Personal income tax

- Non-resident employees are entitled to the taxpayer's standard tax credit (CZK 24,840, approx. EUR 934 per year); originally, only Czech tax residents (or non-residents with more than 90% of their income taxable in the Czech Republic) were entitled to this tax credit.

## Legal and other developments

### Labour code

- On 14 April 2008, the Constitutional Court annulled some parts of the Labour Code because it considered that they violated the Czech Constitution. This affected, among other things, the relationship of the Labour Code to the Civil Code (the latter being newly applicable in labour-law relationships unless the Labour Code provides differently), the possibility of agreeing different terms of employment from the Labour Code provisions, and the powers of trade unions, which have now been limited to conform with the constitution.

### Environmental law

- The Act on Environmental Liability has been adopted by the Czech Parliament. This Act implements the EC Environmental Liability Directive 2004/35/CE and introduces into the Czech law the concept of liability for species and natural habitats, water and land existing alongside owners' liability for their property. The Act will take effect on 17 August 2008, but provisions on obligatory insurance covering environmental liability will not come into effect until 2013.
- After the last amendment to the Act on Waste, whereby some aspects of EC Regulation 1013/2006 on the Shipment of Waste have been implemented, the Act could be subject to another, much broader, amendment in 2008 or 2009. In this amendment, many areas of the legislation could be modified, including those covering the disposal of batteries and accumulators, and the Waste Electrical and Electronic Equipment (WEEE) law.

### Consumer protection

- In February 2008, the Consumer Protection Act was amended by the transposition of Directive No. 2005/29 of the European Parliament and of the Council concerning unfair business-to-consumer commercial practices in the internal market. The main new item is a general prohibition against unfair commercial practices, including especially misleading or aggressive commercial practices.

# Estonia

## Corporate income tax changes effective from 1 January 2009

The Estonian Parliament passed amendments to the Income Tax Act on 26 March 2008, which will be effective from 1 January 2009. The amendments do not affect the further reduction of the income tax rate adopted in 2007, under which the flat rate of income tax in Estonia will be reduced by 1% percentage point per annum until it reaches 18% in 2011.

### Changes in corporate taxation

These amendments are intended to bring the Income Tax Act in line with Parent-Subsidiary Directive (90/435/EEC) while leaving the main principles of the tax system (i.e. exemption of undistributed profits) unaffected.

According to the amendments, the tax base for corporations will generally remain the same. The taxable base includes any profits that are distributed during a calendar year as well as any hidden profit distributions (entertainment and other promotional expenses, gifts and donations above prescribed limits, non-business expenses, transfer pricing adjustments, etc.). Companies' earned but undistributed profits will remain tax-exempt. However, the corporate tax base will also include profits from liquidations, share buy-backs and capital reductions, which are currently only taxed at the recipient.

### Tax period

From 2009, the tax period will be the financial year for both resident and non-resident legal entities. The existing monthly tax-exempt limits prescribed for entertainment and other promotional expenses, gifts and donations will be applied as adjusted annual tax-exempt limits. However, the monthly tax period will continue to be applied in respect of fringe benefits for employees, on which companies must pay both income tax and social tax (on a grossed-up basis).

### Advance payments

Resident companies and permanent establishments of non-resident companies must make twice-yearly advance payments of income tax, which will be based on the average amount of taxable items (distributions of dividends, entertainment and other promotional expenses, gifts and donations above prescribed limits, non-business expenses, transfer pricing adjustments, etc.) of last three tax periods (i.e. on the taxable items of three tax years, excluding fringe benefits).

During the transition period between 2009 and 2011, different rules apply to advance payments. For example, in 2009 there will be four advance payments to be paid by 10 March, 10 July, 10 October of the current year and by 10 March of the following year (i.e. in 2010). The amount of the advance payments will depend on the total amount of taxable items for 2006-2008.

The advance payments do not have to be paid during the tax period if the amount of a single advance payment does not exceed EEK 30,000 (approx. EUR 1,900). Also, the advance payments will not be due during the first tax period of a new Estonian company or permanent establishment.

In addition, resident companies and permanent establishments may submit a case to the Tax and Customs Authorities for the reduction of or exemption from advance payments if they expect their tax liability in the current tax period to be significantly lower than in previous tax periods.

### Liquidation proceeds, share buy-backs and capital reductions

The tax treatment of proceeds from liquidations, share buy-backs and capital reductions will change significantly from 1 January 2009. Under the existing income tax legislation, such payments are taxable under the capital gains regime and are taxable for the shareholder, not the Estonian company. The gain is calculated as the difference between the funds received by the shareholder and the acquisition cost of Estonian company's shares.

From 1 January 2009, funds received from liquidations, share buy-backs and capital reductions will be subject to general distribution tax for the Estonian company, i.e. the distributor of the income. This type of income will thus be taxed like dividends distributed by the Estonian company and treaty relief will no longer be available for these types of income. Additionally, non-residents will no longer be required to submit tax returns to the Estonian Tax Authority in respect of such income.

Until the end of 2008, for tax treaty purposes it will be possible to treat this income as capital gains, which are generally only taxable in the country where the recipient of the income is resident. However, it will be advisable to have this confirmed by the Estonian Tax and Customs Authorities in advance and in writing before relying on tax treaty protection.

## Dividends and royalties paid to non-residents

Another significant change in Estonian income taxation concerns the complete abolition of withholding tax on dividends and royalties (e.g. license fees and payments for the use of industrial, commercial or scientific equipment) paid to non-residents from 1 January 2009.

## Extension of the exemption and credit methods

The adopted amendments extend the scope of both the exemption and credit methods to be used for the avoidance of double taxation in respect of foreign income derived by Estonian resident companies. Thus, from 1 January 2009 there will no longer be a threshold for the application of participation exemptions (currently, an Estonian company must have at least 15% participation in the capital or voting power of the foreign subsidiary).

From 2009, as a general rule, profits distributed by Estonian companies will be exempt from

corporate tax if these are paid out of dividends, funds received from a liquidation, share buy-back or capital reduction received from the EU or EEA or a Swiss resident company. This exemption applies regardless of whether the underlying profits of such foreign companies have been subject to tax or not. In addition, foreign profits re-distributed by Estonian companies may also be exempt from corporate tax if they are received from third-country companies (other than EU- or EEA- or Swiss-resident companies), provided that either the underlying profits have been subject to foreign corporate tax or withholding tax.

## Conclusion

In the light of the corporate tax changes described above, despite the transition to the annual tax period and new advance payments, the Estonian corporate tax base remains generally the same and includes any profits distributed (incl. dividends, hidden profit distributions and other taxable payments). Undistributed corporate profits will also remain tax-exempt from 1 January 2009.



# Georgia

## Georgia continues the rapid implementation of changes in tax legislation

The Georgian parliament has introduced amendments to tax legislation which are effective from 1 January 2008. While most of the changes are aimed at clarifying grey areas in the legislation, changes in tax rates and administration have also been introduced as part of continued efforts to make Georgia more attractive for foreign investment.

Specifically, some new business types have been introduced for Georgian tax purposes. However, the Georgian government has not yet issued clear definitions of these business types, or instructions, guidelines or criteria about qualifying for this status, although the following types of companies will have specific benefits under the new legislation:

- International Financial Companies;
- Free Warehouse Enterprises; and
- International Enterprises.

This status is subject to state registration and will be granted for future calendar years in the form of a certificate. In order to obtain such status, a company representative should submit an application to tax authorities. Again, the requirements have yet to be published.

In addition to the above, there is a proposal to liberalise the tax legislation further, by reducing the current personal income tax rate from 25% to 15% over the next five years, and making dividends and interest tax-exempt. However there has been no official announcement regarding this proposal yet.

## Corporate taxation

### Corporate tax

- The following are exempt from corporate income tax:
  - Gross income up to GEL 100,000 (approx. EUR 42,900), for an entity engaged in agricultural production, if it is received from the primary supply of goods before further manufacturing. This is an annual exemption, available up to 1 January 2010;
  - The amount of income received from agricultural production that is reinvested in the same industry. Exemption is available up to 1 January 2010;
  - Profit received from financial services conducted by “International Financial Companies”;
  - Gains on sales of securities issued by “International Financial Companies”;

- Profits received from sales of bonds, as defined by the “Law of the Securities Market”, that are traded on the Georgian stock exchange, where their free trading coefficient exceeds 25%, according to official information;
  - An exemption on income received by non-residents from leasing property (which is not related to their permanent establishment in Georgia);
  - Interest received from government bonds;
  - Capital gains on sales of government bonds;
  - Income received from re-exporting goods from an independent warehouse by a “Free Warehouse Enterprise”; and
  - Income received by an “International Enterprise” from its permitted activities conducted in a “Free Industrial Zone” (also a recently introduced, but as yet undefined, concept).
- If an “International Financial Company’s” income from Georgian sources exceeds 10% of its gross income, this will be subject to a penalty of 100% of the excess amount.
  - No loss carry-forward will be allowed for the following entities: International Financial Companies, Free Warehouse Enterprises and International Enterprises.

### Withholding tax

- Income received by non-residents from Georgian sources for insuring and/or reinsuring the risk by an enterprise or an organization will be exempt.
- Dividends and interest will be exempt if:
  - The dividends are received from stocks issued by International Financial Companies; and
  - The dividends are from securities that are accepted for trading on the stock exchange under the definition of “Law of the Securities Market” and, according to the market information, their free trading coefficient exceeds 25%.

## Indirect taxation

### VAT

- The following are VAT-exempt:
  - Imports and supplies of national/foreign currency, securities and equity capital stakes (applicable to legal transactions conducted since 1 June 2005); and
  - Supplies of goods/services between enterprises in a “Free Industrial Zone”, and also the supply of goods in a “Free Warehouse” to a registered VAT payer.

## Customs duties

- Goods produced in a “Free Industrial Zone” are free of customs duties when imported to an area outside the zone.

## Individual taxation

### Personal income tax

- The following are exempt from personal income tax:
  - The gross income of an individual engaged in agricultural production, not exceeding GEL 100,000 (approx. EUR 42,900), applicable before 1 January 2010;
  - Profit received from the sale of securities issued by an “International Financial Company”;

- Profit received from the sale of bonds, as defined by the “Law of the Securities Market”, that are traded on the Georgian stock exchange where, according to official information, their free trading coefficient exceeds 25%;
- Income received by non-residents from leasing property, if it is not related to their permanent establishment in Georgia;
- Interest received on government bonds;
- Profit received from the sale of government bonds; and
- Income received by residents from non-Georgian sources.

## Other taxes

### Real estate and land tax

- Property located in a “Free Industrial Zone” is exempt from property tax.



# Hungary

## Change for registered shareholdings and controlled foreign companies

Under the previous rules, registered shareholdings had to be registered with the Tax Authority within 30 days of acquisition. Additionally, capital gains earned on the sale of a registered shareholding could be exempted from corporate income tax if the company had held the shareholding for at least two years before the sale.

After 1 January 2008, the contract or other document under which a registered shareholding has been acquired must be attached to the registration form submitted to the Tax Authority. The capital gains earned on registered shareholdings are now deductible for corporate income tax purposes if the owner has held the shareholding for at least one year prior to the sale.

Since 1 January 2008, companies that have their registered office or a permanent establishment or are resident in an EU Member State, an OECD Member State or a country with which Hungary has a Double Tax Treaty are no longer considered foreign controlled companies. The issue of whether these companies have a real business presence in Hungary does not have to be examined. The fact that a company no longer qualifies as a controlled foreign company will not prevent the Tax Authority from examining the terms of the transactions completed by the company and whether it has been exercising its rights properly.

These changes result in additional documentation obligations but also represent new opportunities for adjusting the tax base.

## Corporate taxation

### Transfer pricing

- Transfer pricing rules also apply to non-monetary dividend payments and to any payment of share by means other than money in the event of dissolution without succession, if the non-monetary contribution is paid by or the share is received by a member (shareholder) with a majority interest.

## Indirect taxation

### VAT

- The new VAT Act extended the application of the reverse-charge mechanism to a variety of activities in addition to the sale of waste materials, including construction and assembly, and services related to real property (repair, maintenance and cleaning). However from 1 May 2008, the scope of real-estate related

services subject to domestic reverse-charge was significantly limited on the basis of practical difficulties arising in the first four months of the year.

### Excise duties

- The excise duty rates were increased on 1 April 2008 and are now as follows:
  - HUF 7,800 (approx. EUR 31) per thousand cigarettes plus 28.2% of the retail sale price, but a minimum of HUF 14,460 (approx. EUR 57) per thousand cigarettes;
  - 28.5% of the retail price for cigars and cigarillos;
  - 52% of the retail price, but a minimum of HUF 5,055 (approx. EUR 20) per kilogram for fine-cut tobacco; and
  - 32.5% of the retail price, but a minimum of HUF 5,055 (approx. EUR 20) per kilogram for other tobacco.
- The tax base per cigarette also depends on the length of the cigarette and is double if the length of the cigarette is from 9 but less than 18 cm, triple if the length is from 18 but less than 27 cm, and so on.



# Kazakhstan

## Oil export duty introduced; minerals export duty to follow?

On 8 April 2008, the government issued a decree introducing a new export customs duty on crude oil, petroleum coke, and bitumen. The key features of the new decree include:

- Applies to crude oil at the current rate of USD 109.91 per tonne (based on Q1 2008 average world oil price).
- The rate is subject to re-calculation based on a progressive scale for average world prices of crude oil. For example, according to the scale, if the world price of crude oil is equal to USD 876 per tonne, the customs duty rate increases to USD 196.03 per tonne.
- Applies to crude oil at the fixed rate of USD 27.43 per tonne for payers of rent tax on oil exports (no sliding scale).
- Applies to petroleum coke and bitumen at USD 82.20 per tonne.
- The export duty does not appear to apply to gas or gas condensate.

Importantly, the export customs duty does not apply to subsurface users whose contracts contain stability clauses covering export customs duties. The government is currently compiling a list of subsurface companies which are exempt on this basis.

The decree was published on 17 April 2008 and came into effect on 17 May 2008.

The government has announced plans to introduce a similar export customs duty on minerals. The list of minerals subject to the export customs duty and the corresponding rates is currently being drawn up by the government. It is anticipated that the decree will be issued within the next couple of months.

## Corporate taxation

### Corporate tax

- The State Tax Committee of the Ministry of Finance has issued a letter concerning the taxation of securities sold on foreign stock exchanges. The letter confirms that capital gains from the sale of shares and bonds in the highest listed categories of any stock exchange (i.e. not only the Kazakhstan Stock Exchange), including those located in other countries, are exempt from capital gains tax in Kazakhstan.

### Transfer pricing

- The draft Transfer Pricing Law was approved by Majilis on 19 March 2008. Significant aspects of the draft

Transfer Pricing bill include:

- Introduction of the arms' length principle;
- Application of transfer pricing control to related and independent parties;
- Revocation of the 10% 'safe harbour' for independent party transactions;
- Introduction of price ranges instead of single benchmark prices;
- Application to cross-border and certain domestic transactions, including transactions by subsurface users whose products are intended for export;
- Introduction of an Advance Pricing Agreement ("APA") mechanism;
- List of documents and information required to support transfer prices;
- Additional methods for market price determination – 'profit split' method and 'transactional net margin' method;
- Application of the 'resale price' method only to distribution activities and simple assembly/processing activities.

## Investment incentives

- The President has issued a decree establishing a special economic zone in the Atyrau region until 31 December 2032, the "National Industrial Petrochemical Technopark".

## Indirect taxation

### VAT

- For certain imported goods, import VAT can be paid by a special "offset" method, which generally allows the amount of import VAT to be reflected in the VAT declaration as output VAT and, at the same time, included as input VAT available for offsetting (without actually having been paid). The list of goods on which import VAT can be paid by the "offset" method was updated on 15 March 2008.
- Certain fixed assets imported by a lessor for transfer to a lessee under a financial lease arrangement may be exempt from import VAT. The list of the leased fixed assets that can be imported to Kazakhstan exempt from import VAT has been updated. The commodity codes for certain items have also been changed.

### Customs duties

- On 8 February 2008, a Government decree came into effect, under which the customs duties on imported agricultural equipment were withdrawn or significantly reduced. For example, the duty rate on track-type

tractors was reduced from 15% to 5%, and cultivation equipment (cultivators, ploughs) is now zero-rated.

- By contrast, increased custom duty rates on the following oil products were approved with effect from 1 March 2008:
  - on light, medium and heavy distillates, at the rate of USD 123.3 (from USD 83.3) per tonne;
  - on heavy distillates in the form of liquid fuels, at the rate of USD 82.2 (from USD 55.5) per tonne.

## Excise duties

- On 19 February 2008, the Government issued a decree increasing excise rates on filter cigarettes from KZT 315 (approx. EUR 1.78) per 1,000 items to KZT 400 (approx. EUR 2.26) per 1,000 items, and for non-filter cigarettes from KZT 180 (approx. EUR 1.02) per 1,000 items to KZT 200 (approx. EUR 1.13) per 1,000 items. The decree came into effect on 4 March 2008.
- The Kazakhstan Government has issued a decree introducing a temporary quota of 46,736 tonnes on white sugar. The quota is valid until 1 October 2008. The decree came into effect on 10 March 2008.

## Individual taxation

### Personal income tax

- The State Tax Committee has issued a letter stipulating that an individual resident in Kazakhstan is subject to 10% taxation by self-assessment on dividends received from a non-treaty country. This is despite the fact that the Tax Code specifically states that individuals' dividend income is normally taxed at the rate of 5%.
- The State Tax Committee has issued a letter concerning the taxation of securities sold on foreign stock exchanges. The letter confirms that capital gains from the sale of shares and bonds in the highest listed categories of any stock exchange (i.e. not only the Kazakhstan Stock Exchange), including those located in other countries, are exempt from capital gains tax in Kazakhstan.

- On 6 December 2007, the Law concerning the 2008 State Budget was signed by the President. Effective from 1 January 2008, the Law sets the following indicators for the calculation of certain taxes and administrative fines:

- Monthly calculation index (MCI): KZT 1,168 (approx. EUR 6.6);
- Minimal monthly salary: KZT 10,515 (approx. EUR 60).

## Social security

- Amendments to the Tax Code in relation to social payments have been introduced. The obligation to pay maternity leave allowances has been transferred from employers to the State. Accordingly, maternity leave allowances paid by the employer become non-deductible for corporate income tax purposes and liable to personal income tax.
- From 1 January 2008, companies working under subsurface use contracts concluded in accordance with the legislation of the Republic of Kazakhstan before 1 January 2004, in which they were guaranteed tax regime stability, should reduce their stabilized "social charges" or social tax due by the amount of the social insurance contribution calculated in accordance with the current Social Insurance Law.
- The above means that such companies should start calculating and paying social insurance contributions to the relevant social insurance fund individually for each employee under his/her social identification number (SIC). The contributions can be offset against the stabilized social charges (which are currently paid under the social tax code).
- The above does not represent an additional charge for companies, as the overall payments to the state budget should remain unchanged. However, part of the payments formerly paid as social taxes should be re-directed to the social insurance fund.
- New Obligatory Social Insurance Contribution rates for 2009/2010 have been introduced by a Government Decree:
  - 4% of the taxable base, starting from 1 January 2009; and
  - 5% of the taxable base, starting from 1 January 2010.

## Legal and other developments

### Foreign currency regime

- The Rules on maintaining taxpayers' accounts have been amended by an order of the Ministry of Finance, in part related to subsoil users that meet their tax obligations in foreign currency. According to this Order, exchange rate differences that arise on subsoil users' tax accounts due to the difference between exchange rates on the tax return submission date and on the tax payment date should be adjusted on the taxpayers' accounts.
- The Board of the National Bank increased the refinancing rate from 9% to 11% with effect from 1 December 2007. For tax purposes, the refinancing rate is used when computing penalty interest on late tax payments.

### Labour code

- A decree establishing new work permit rules was issued on 19 December 2007. Notable changes introduced by the new rules include:
  - A scaling system will be introduced for foreign labour with a marginal rate established

for each category; the scaling will be based on (i) education, (ii) length of professional practice and (iii) local labour market demand.

- Exemption from work permits for heads of banks and insurance companies is abolished (instead the exemption is introduced for managers and specialists working in the regional Almaty Financial Centre).
  - A simplified procedure for obtaining work permits will apply for the CEOs of companies that are more than 50% owned by foreign shareholders (no data on the Kazakhstan labour market will be required).
  - An employer's representative may participate in meetings of a Commission which decides on issuing work permits.
  - Decisions to issue work permits will take into account employees' professional qualifications.
  - The duration of business visits by expatriate employees without a work permit being required is extended to 60 calendar days.
- The Decree comes into effect on 1 June 2008.

### Environmental law

- The Kazakhstan Government has issued a decree introducing new base rates for the environment pollution fee for 2008. The base rates range widely, from KZT 2.8 (approx. EUR 0.02) to KZT 15,654 (approx. EUR 90) per tonne, depending on the type of emission or discharge.



# Latvia

## EU Commission questions Latvian tax law

Latvia has received a formal information request from the European Commission regarding the tax treatment of dividend payments to individuals. Currently, when a Latvian company pays dividends to Latvian residents, no personal income tax should be withheld, while dividends to foreign residents are subject to 10% withholding.

The EU Treaty lays down four fundamental freedoms, to which Latvia is committed as an EU Member State. One of these is the free movement of capital, established to allow the unhindered flow of funds between Member States. Thus, a person from one Member State who invests in a company established in another Member State is entitled to the same tax treatment as a person of that other state. It is discriminatory that a Latvian company withholds no tax on dividends it pays to a Latvian resident, and then 10% tax must be withheld on dividends paid to a person resident in another Member State.

The information request does not, however, mean that any proceedings have been started against Latvia. Latvia has two months (ending 31 May) to reply to the request by giving details of applicable tax provisions and reasons for the discriminatory tax treatment. Assuming that Latvia does not wish to challenge the commission, this situation has two possible solutions:

- Not apply tax to dividend payments to residents of any Member State; or
- Tax dividends that a Latvian company pays to Latvian residents.

However, it is clear that neither solution will be implemented soon, as normally the commission grants Member States sufficiently extended transitional periods for tax amendments and notification of taxpayers.

## Indirect taxation

### VAT

- On 31 January 2008, the Latvian parliament amended the VAT Act. All the amendments came into force on 26 February, except for the one recasting section 35, which the transitional rules determine will take effect along with amendments to the Taxes and Duties Act.

- Under the amendments, if a taxable person makes zero-rated supplies, or the taxpayer's customer has to account for VAT, or if the trader makes transactions involving second-hand goods or provides travel services, a tax invoice may refer either to the relevant section of the Latvian VAT Act or to the relevant article of the 6th Directive, or make any other reference indicating the regime applied. When applying any of the other special rules, namely farm subsidies, timber transactions, investment gold transactions, electronic services and new vehicle supplies, a tax invoice must still refer to sections of the Latvian VAT Act.
- According to the procedure for refund of overpaid VAT, the State will refund the difference between any output tax that is properly calculated and any input tax that is reasonably recoverable. Taxpayers engaged in commerce often apply any overpaid VAT towards payment of other taxes. Before the amendments, there were restrictions on applying overpaid VAT towards payment of excise on petroleum products and alcoholic drinks, as well as customs payments. Once the amendments come into force, the customs restrictions will only apply to import duty and export duty. The State Revenue Service will continue to refund any overpaid VAT within 30 days of receiving a reasoned application and supporting documents from that taxpayer.
- The section, which determines liability for VAT offences, has been recast to bring it into line with the penalty procedure prescribed by the Taxes and Duties Act. Now a penalty will be imposed at 30% or 50% (not 100%), also where output tax is reduced or recoverable input tax is increased. A 100% penalty will only be imposed for an illegally issued tax invoice resulting in illegal collection of VAT. Given the VAT calculation rules, certain VAT offences retain a 10% penalty. This penalty would be imposed if a taxable person imports a fixed asset and any VAT appearing in his customs declaration may be reported as both output tax and input tax on his VAT return, but he fails to report it, or if a taxable person wrongfully fails to account for VAT on any items acquired. Any other VAT offences that are not defined in the VAT Act as amended will be liable to penalties prescribed by the Taxes and Duties Act.
- The amendments restrict the exemption for scientific research. According to the transitional rules, the exemption will be available only for scientific research financed from public foundations, central and local government or international institutions, started before 1 July 2008, until completion.

## Individual taxation

### Personal income tax

- From 1 January 2008, the minimum wage (i.e. the minimum amount that can be paid to a full time employee) has been increased to LVL 160 (approx. EUR 230) a month (in 2007 it was LVL 120, approx. EUR 170).

### Other taxes

- Amendments to the Taxes and Duties Act have set deadlines for compulsory electronic filing and have substantially amended the sections that prescribe tax penalties.
- All taxpayers other than employees will have to file their tax and information returns by electronic means. This requirement will apply to state funded agencies and to companies partly owned by central and/or local government from 1 January 2009 and to other taxpayers from 1 January 2010 (except for employees).

Taxpayers whose registered office or declared residence is located in an area without an internet infrastructure are permitted to file paper returns until 1 January 2011.

- Additional requirements have been introduced for taxpayers applying to the State Revenue Service (SRS) for an extended deadline for tax payment. The SRS will assess their actual financial position and consider a number of factors, such as whether the taxpayer has met previous deadlines, whether he has received any extensions and whether he has paid by such extended deadlines. It will also be important that the taxpayer has met deadlines for filing his tax and information returns and that he cooperates with the SRS. The grant of an extension will also depend on whether any offences were detected in the most recent tax audit.
- The amendments also reduce the penalty for a repeat offence from 100% to 70% of the tax lost. A persistent offender that again repeats the same offence on one or more occasions within three years will be penalised for each of the subsequent offences at 100%, instead of the previous 150%, of the tax lost.



# Lithuania

## Corporate tax developments

Amendments to the law on corporate income tax, which are applicable from a tax period starting in 2008, permit a threefold deduction of R&D expenses for the tax period in which they are incurred. The amortisation and depreciation rates of the long-term assets used in R&D activities were reduced to two years if certain conditions are met.

From a tax period starting in 2008, tax losses can be carried forward for an unlimited period of time if certain conditions are met. Losses incurred from the transfer of securities and/or financial derivatives can be carried forward for five successive periods. These tax losses may only be offset against income generated from disposals of securities and/or financial derivatives.

## Corporate taxation

### Double Tax Treaties

- Lithuania has now signed Double Tax Treaties with 45 countries. The latest treaty was concluded with Korea, and is applicable from 1 January 2008.

## Individual taxation

### Personal income tax

- Bonuses from retained earnings which are paid to the board members or supervisory board are taxable with personal income tax (24%) from a tax period starting in 2008.

## Legal and other developments

### Labour code

- On 23 February 2008 amendments to the Lithuanian Law on Legal Status of Foreigners came into force. The amendments are related to the transfer of Schengen “acquis” to the domestic legal acts.



# Macedonia

## New law on concessions and public-private partnerships

In January 2008, the Macedonian Parliament adopted the new Law on Concessions and Public-Private Partnerships (“PPP”). The aims of this new law are to promote and enable private initiatives in financing public services, to ensure equal access and transparency in the procedure for granting concessions, and to achieve high-quality and effective performance of the works and services under the concessions granted and the public-private partnership agreements.

Concessions and PPPs could be established as contractual partnerships or institutional partnerships. Services that can be subject to concessions include construction activities, public services and the use of public property.

Concessions will be granted by the Government on behalf of the Republic of Macedonia. The Government may authorize the competent minister for the object of a concession to conclude the concession contract on its behalf. The Council of the City of Skopje will grant concessions on behalf of the city of Skopje and its municipalities and the mayor will be authorised to conclude the concession contracts.

The concession period will be 35 years without the right to an extension, commencing on the date the concession contract is concluded. As an exception, a concession



period could be extended in cases of “vis major” and temporary suspension of concession activities due to public order protection action which was not initially predicted.

## Procedure for granting concessions

The procedure for granting a concession includes a public bid, organised and conducted as either an open bid process, a limited bid process, or competition dialogue.

A Concession Agreement will be concluded in writing between the concession Provider and the winning bidder within three months of the final decision being made. The contents of the Concession Agreement must be as set out in the law.

## Public-Private Partnership

A public-private partnership is a form of joint venture between the public and the private sectors. Both partners gain profits for given periods, but the public sector usually gains the larger profit. The public-sector partner finds a way to realize big investment projects without proportionally burdening the budget and creating a fiscal deficit, and the private-sector partner has a field for new investments in objects of public interest.

The most serious projects which the country will realise together with its private-sector partners will be the construction of primary and secondary schools, as well as transport, construction and health projects. The Public-Private Partnership initiative is a big challenge for the municipalities, which will now be able to start implementing projects which they were unable to realise through traditional financing methods, mostly because of the extreme shortage of cash and lack of human resources.

The new Law on Concessions and Public-Private Partnerships facilitates this kind of opportunity in the Republic of Macedonia for the first time. By joining forces with the private sector, the country plans to build hospitals, schools, roads, shopping malls and business centres. The aim of the public-private partnerships, according to the experts, is to mobilise private capital and to focus it on these types of project.

The procedure for granting PPP Agreements and the content of PPP Agreements are as described above.

Ministry of Finance will be obliged to maintain a register of the concessions and Public Private Partnership agreements that are granted. This register will be published on the Ministry of Finance’s web page.

# Moldova

## Major amendments to the direct and indirect taxation legislation

During the first quarter of the current year, two major amendments to the legislation on direct and indirect taxation were implemented in Moldova. These changes concern (i) the introduction for official use in Moldova of the Commentaries to the OECD Model Tax Convention on Income and on Capital, and (ii) the introduction by the European Union (EU) of Autonomous Trade Preferences (ATP) for Moldova.

In particular, on 27 March 2008 the Moldovan Ministry of Finance issued an Order (officially published on 4 April 2008) according to which the Commentaries to the OECD Model Tax Convention on Income and on Capital should be used by the Moldovan Tax Authorities (MTA) and taxpayers as guidance on the interpretation of Double Tax Treaties and, correspondingly, for tax administration purposes.

Additionally, on 21 January 2008, the EU Council of Ministers adopted the Regulation introducing ATP for Moldova, which became possible as a result of the satisfactory level of implementation of the new legislation in Moldova, mainly in relation to monitoring the origin of goods.

From 1 March 2008 and until 31 December 2012, Moldova will benefit from the ATP regime which allows unlimited duty-free access to the EU market for all products originating in Moldova, except for certain specific agricultural products. Such agricultural products will be accepted for import into the EU either with exemptions from customs duties within the limits of specific tariff quotas (e.g. fresh, chilled and frozen meat of bovine animals, dairy products, common wheat, barley, maize, white sugar) or with exemption of the ad valorem component of the import duty (e.g. tomatoes, grapes, apples).

In order to benefit from these preferential terms for imports of goods into the EU, compliance with origin and certification requirements will be necessary.

## Corporate taxation

### Double Tax Treaties

- Double Tax Treaties with the Kingdom of Spain and with the United Kingdom of Great Britain and Northern Ireland were recently ratified by the Moldovan Parliament but have not yet come into force.
- As stated in the previous section, from 4 April 2008, MTA and taxpayers are advised to use the Commentaries to the OECD Model Tax Convention on income and on capital as guidance on the interpretation of the provisions of Double Tax Treaties, as well as for tax administration purposes.

## Indirect taxation

### VAT

- In accordance with Governmental Decision No. 287 of 11 March 2008, the Moldovan VAT refund regulations were amended and simplified. Under the new regulations, the MTA's decisions on VAT refunds will be based on a risk assessment method. VAT refunds may be made without a prior tax audit, provided certain conditions are met.
- Under certain amendments to the Tax Code, VAT payers will be entitled to a VAT refund of the VAT incurred on investments made from 1 January 2008, provided such investments were made in Moldova, except for Chisinau and Balti (i.e. before the implementation of these amendments, such refunds were only available if VAT payers were registered and carried out their activity in Moldova, except for Chisinau and Balti). VAT refunds of the VAT incurred on investments in dwellings and the means of transport are not available.

### Excise duties

- From 1 January 2008, certain new rules concerning maximum retail prices for filter-tipped cigarettes were approved. From 1 January 2009, the import, production and sale of filter-tipped cigarettes will not be possible unless the maximum retail price is printed on the pack.

## Individual taxation

### Personal income tax

- From 1 January 2008, resident individuals leasing immovable properties are liable to pay a tax of 5% of the contractual value. Individuals are also required to register signed contracts within three days term at their local tax office. This tax must either be paid monthly by the 2nd of the respective month or can be pre-paid. For contracts concluded after the 2nd of the month, the deadline for paying the tax for the first month is the second day after the agreement is signed.

### Social security and health insurance contributions

- The fixed health insurance contribution has been set at MDL 1,894 (approx. EUR 110) for 2008.

## Legal and other developments

### New accounting law

- A new Accounting Law came into force on 1 January 2008. According to the law, from 1 January 2009, "entities of public interest"

(see definition below) will be required to prepare financial statements in accordance with the International Financial Reporting Standards (IFRS).

- Entities of public interest are entities which have exceptional importance due to their field of activity, size, number of workers or clients, and are financial institutions, investment funds, insurance companies, non-government pension funds, commercial companies whose shares are listed on the Moldovan Stock Exchange, or other types of entities that hold a dominant position in the market and have exceeded the limits of two of the three criteria below for the last two consecutive accounting periods:
  - total revenues: MDL 120 million (approx. EUR 7.2 million);
  - total balance sheet value: MDL 60 million (approx. EUR 3.6 million); and
  - average registered number of workers for an accounting period: 500 persons.
- Other entities using the double-entry accounting system may keep their accounts in accordance with either the IFRS or the National Accounting Standards (NAS), pursuant to their accounting policy.
- A new Law on audit activity also came into force on 1 January 2008 and provides the legal framework for audit activity performed by audit companies and private audit entrepreneurs. The auditing of annual financial statements, including the consolidated statements, is compulsory for entities of public interest.



# Montenegro

## Ministry of Finance has drafted amendments to Corporate Profit Tax Law

The Ministry of Finance has drafted amendments to the Corporate Profit Tax Law (CPT Law). The public discussion of the draft amendments lasted until 16 May 2008. After this, the Government should draft the final amendments and forward them for the regular parliamentary procedure. However, it remains uncertain when the proposed draft amendments will be adopted.

The following major changes are proposed:

### Permanent Establishment (PE)

The draft amendments to the CPT Law define the concept of a permanent establishment in greater detail. According to the amendments, a PE can be created by a dependant agent (i.e. one that conducts business in the name of a non-resident entity and is authorised to conclude contracts in the name of the non-resident entity). However, any activity of a dependant agent that are of a preparatory or auxiliary nature should not create a PE (e.g. storage, keeping stocks for storage, the collection of information).

An independent agent (e.g. a broker) that acts wholly or mainly in the name of a non-resident entity can create a PE as well if the terms of business and the financial relations between them differ from those that would exist between unrelated parties.

### Adjustment of revenues and expenses

Revenues from dividends and shares in other legal entities will not be included in the tax base if the payer of that income qualifies as a taxpayer under the Montenegrin CPT Law.

Debt provisions in respect of parties that are creditors at same time will not be regarded deductible.

The required acquisition value of fixed assets that qualify for tax depreciation will increase to EUR 500 (as opposed to the current threshold of EUR 200).

Expenses incurred for health, educational, scientific, religious, cultural, sports and humanitarian purposes, as well as environmental protection, will be recognised as expenses up to 3.5% of total revenue, as opposed to the currently prescribed 3%.

Interest expenses incurred in relation to related parties are recognised as an expenditure for CPT purposes up to the arm's length value (i.e. any amount exceeding this limit is included in taxable base).

### Capital gains

According to the draft amendments, a capital gain represents the positive difference between the selling price and the price recorded in a company's books adjusted by tax depreciation (recorded at acquisition value or fair value).

Only 50% of capital gains realized are included in the CPT base.

Capital gains realized in a change of status (e.g. a merger or division) will be subject to deferred taxation. The tax liability will not arise until the new legal entity sells the property it has taken over. A similar deferment is proposed if the owner of a transformed company receives shares or a stake in a new company plus cash receipts that do not exceed 10% of the nominal value of shares or stakes obtained.

### Inter-company dividends

When a non-resident subsidiary company's dividends are included in the taxable base of its parent company, the resident parent company has the right to decrease its tax liability by applying the credit method to the withholding tax. The tax credit cannot exceed the amount of (corporate) tax that would have been paid in Montenegro. Unused tax credits can be carried over to the tax account of the parent enterprise for five years. The parent company is required to own 25% of a non-resident subsidiary for at least two years before filing the tax return.

### Withholding tax

The draft amendments to the CPT Law extend withholding tax levied on income paid to non-resident legal entities to the following income: income from rights related to copyrights, income from immovable and movable property, premium income from insuring/reinsuring a risk in Montenegro, income from telecommunications services provided between Montenegro and other countries, and income from consulting services, marketing research services, tax consulting, business consulting and audit services.

Dividends and shares in profits paid to residents and non-residents (both individuals and legal entities) will also be subject to withholding tax.

The amendments decrease the withholding tax rate from 15% to 9% (except for tax on interest paid until 1 January 2010 at the prescribed rate of 5%).

Under the amendments, the withholding tax exemption on dividends and shares in profits used to increase a taxpayer's initial capital will be abolished.

According to the amendments, Double Tax Treaty provisions on withholding tax will continue to apply. However, in order to apply the tax rates prescribed by a Double Tax Treaty, the non-resident must prove:

- beneficiary ownership of the income; and
- residence of a state covered by the relevant Double Tax Treaty, by submitting a tax residence certificate.

## Transfer pricing

The draft CPT Law amendments replace the definition of related parties with the definition given in the Tax Administration Law.

According to the draft amendments, related parties are entities that have a special connection which may have a direct influence on the terms or economic results of transactions between them.

Special connections are defined by the Tax Administration Law and include the following:

- an ownership interest of 25% of the shares of another entity;
- at least a 25% direct or indirect influence over another entity;
- direct or indirect control of the entity by another party;
- relations between dependent parties or parties which are under the direct or indirect control of a third party;
- direct or indirect control over the entity through at least 25% of the voting rights in the controlled entity.

## Indirect taxation

### Customs duties

The Parliament of Montenegro has adopted amendments to the Customs Law which are applicable from April 2008. The major changes (in brief) are as follows:

- Under the amendments to the Customs Law, a customs agent must be an entity with seat or residence in Montenegro except in the case of transits of goods, temporary imports or declarations of goods in special cases provided by the Customs Law.
- The amendments introduce the term “authorised commercial subjects” and state that a foreign entity must appoint an intermediary for custom procedures. A customs intermediary acts in its own name, but for the account of the foreign entity it represents. An intermediary can be legal entity or an entrepreneur with Montenegrin residence, and must be registered with the customs authorities.
- An authorised commercial subject is a Montenegrin entity that is entitled to a simplified procedure during security and safety inspections.
- The amendments set the conditions for submitting customs declarations and opening duty free shops. The amendments also introduce a new range of penalties, which are higher than previously.
- Parliament is considering the ratification of the Istanbul Convention on Temporary Importation, formulated by the Customs Cooperation Council in 1990.
- The aim of the Convention is to harmonize and simplify the rules of the temporary import regime between the parties in order to improve economic, humanitarian, cultural and social objectives.

## Individual taxation

### Personal income tax

- The Ministry of Finance has issued a new rule book which includes a new annual tax return form which must be submitted by the end of April for the income realized in the previous year. The new tax return form complies with the amendments to the Personal Income Tax Law which have been in force since 1 January 2007.

### Social security

- The social security contribution base is the gross salary. Only pension and disability contributions (PIO) are capped. For 2008, the Ministry of Finance has set the maximum contribution base for PIO contributions at EUR 23,976.14.

## Other taxes

### Law on the financing of self-government

- The Law on the Financing of Self-Government allows municipalities to impose a local surtax on legal entities, rather than just on individuals, at the rate of 13%

(15% for the capital, Podgorica, and the old capital, Cetinje). The amendments to the Law came into force on 1 January 2008.

## Chamber tax

- According to the Commercial Chamber Law, the Chamber of Montenegro is empowered to levy a chamber tax on members' gross salaries. The tax rate is 0.30% for 2008 (instead of the 0.32% rate for 2007). The taxable base is a Chamber member's gross salary.

## Legal and other developments

### Labour code

- The new Law on the Employment of Foreigners has been passed and will come into effect in February 2009. It introduces three types of work permits, a personal work permit (for foreigners who settle in Montenegro), and two types of employment permit (for assignees and locally employed foreigners).

### Intellectual property

- The authority dealing with the protection of IP rights is the Intellectual Property Office of

Montenegro. Although this Office has been established, it is still not operational, and therefore all registrations of IP rights are done through the IP Office in Belgrade, under an agreement reached between the two Offices.

### Consumer protection

- The Law on the technical specifications of goods has been passed. It sets out how the specifications are defined and by which authority, which authority is responsible for keeping the public register of technical regulations and ensuring that the law is implemented.

### Company law

- The Company Law was amended in December 2007 to introduce different requirements and procedures for the restructuring of companies. Also, the minimum number of shareholders in a Joint Stock Company has been reduced to one. Additionally, the Law now differentiates between "open" and "closed" joint stock companies. Heavier fines for breaching the provisions have been introduced.

### Other

- The new Law on Banks has been passed, and is mostly harmonised with international and EU standards. This Law will facilitate a transition towards Basel II.



# Poland

## In search of the “friendly state”

The parliamentary elections held on 21 October 2007 resulted in change of Government. The Civic Platform, which is the major partner in the new ruling coalition, has a reputation as a pro-business party. To uphold this perception, the Platform’s leaders created the concept of the “friendly state”, i.e. the idea of a state that promotes freedom and removes bureaucratic obstacles put before citizens and businesses. Not accidentally, a Friendly State Commission has been set up in the new Parliament.

Unfortunately, this libertarian offensive has not produced any new legislation yet. For the moment, one can only assess the “friendly state’s” assets and liabilities by a number of drafts prepared by the Government and some ideas discussed by the new parliamentary Commission.

## Retroactive personal income tax exemption for Polish expatriates

Following several months of discussion, the Government drafted a law to grant retroactive personal income tax exemption on income earned abroad in the period 2002-2007. This extraordinary legislative measure is meant to address the situation of hundreds of thousands Poles who left the country in recent years, especially after Poland joined the EU on 1 May 2004. Most of them went to the United Kingdom, which did not put up any barriers against employees from the new EU Member States.



Unfortunately, until 1 January 2007 the Double Tax Treaty between Poland and the UK provided no exemption for British income earned by Polish residents. As a result, a huge number of Polish expatriates were subject to tax in Poland on top of their UK taxation. This double taxation, although mitigated by the “credit method” applied in Poland, was widely perceived as unfair and led to massive tax arrears. The draft retroactive tax exemption is intended to improve the situation.

## Suspension of business activity: encouragement to start a small business

Poles are often anxious about registering their own businesses because they are afraid of administrative and fiscal burdens. The most notorious among these is mandatory social security for sole traders. The monthly contribution, if collected at the minimum rate, amounts to the equivalent of EUR 215 per month, and there is no exemption even if a business earns no revenue whatsoever. Former Governments tried to address the issue by granting relief to sole traders in their first 24 months of activity. Nevertheless, there are still numerous reasons to believe that the social security obligations discourage the registration of individual businesses, not to mention their harmful effect on those that are already registered.

Having considered this situation, the Government proposed a bill to allow the temporary suspension of business activity for the period when it generates no revenue. Suspension would free an entity from social security contribution liabilities and most other administrative and fiscal obligations. Thus temporarily shutting down a business whenever it is reasonable to do so would be a safe option. It needs to be stressed, however, that the option discussed would only be available for small businesses which do not hire employees on the basis of employment contracts.

## Friendly State Commission

The Friendly State Commission has not produced any completed draft legislation yet. Nevertheless, to give an idea of its efforts, we will mention two suggestions it has discussed. The first is to abolish the 30% VAT penalty applicable to corporate businesses for understating their VAT. The other is to suspend the legal effect of administrative tax decisions until the court ruling.

The establishment of the Commission was warmly greeted by the general public and by business circles in particular. However, as no tangible success has been achieved so far, the commissioners still have to prove that they are fit for the task of freeing Poland from excessive bureaucratic restraints.

# Romania

## Tax administration reforms

### Joint tax payments

Starting this year, all corporate taxpayers must make tax payments to a single account for most taxes owed to the consolidated state budget. From October 2007 up to the end of the 2007 fiscal year, Romanian taxpayers were offered the opportunity to opt for joint tax payments to a single account, whereas starting this year the procedure is mandatory.

### Electronic filing of tax forms

In 2008, all corporate taxpayers may opt to submit tax returns through the "On-line submission of tax returns" system, available on the portal of the National Agency for Tax Administration on the website of the Romanian Ministry of Economy and Finance. Once the state budget payment obligations have been declared, there is no need to submit hard-copy returns. An online tax filing system was previously only available to large tax payers.

A new provision has been introduced under the Fiscal Procedural Code, according to which legal persons or entities without legal personality which fail to file due tax returns for two consecutive terms are declared inactive unless they have prior written consent from the authorities to be exempted from fulfilling such obligations. According to a Tax Code provision, expenses recorded on the basis of an invoice issued by a taxpayer declared inactive are non-deductible.

## Corporate taxation

### Double Tax Treaties

- The Double Tax Treaty between Romania and Iran comes into force on 1 January 2008. Two new tax treaties, with the Republic of San Marino and Sudan, have been ratified the Romanian parliament. Their implementation, however, is pending until they have been ratified by the other countries' legislative bodies.

### Transfer pricing

- In February 2008, the Minister of the Economy and Finance ("MEF") approved the content of transfer pricing documentation. The provisions of the MEF Order are now supplemented by the Transfer Pricing Guidelines issued by the Organisation for Economic Cooperation and Development (OECD) and the Code of Conduct on transfer pricing documentation for associated enterprises in the European Union.

- During a general or partial tax inspection, taxpayers involved in related-party transactions are obliged to present their transfer pricing documentation upon the written request of the tax authority. The deadline for presenting the documentation to the tax authority is determined by the number of related parties involved in transactions, the number of transactions and their complexity, and the period of time in which the transactions take place. The deadline cannot exceed three calendar months, with the possibility of a single extension equal to the period initially set.
- Taxpayers applying advance pricing agreements issued by the National Agency for Tax Administration are no longer obliged to prepare and present transfer pricing documentation for the transactions and periods to which these agreements refer.
- Failure to present transfer pricing documentation or presenting incomplete documentation following two consecutive requests may result in the tax authorities estimating transfer prices on the basis of generally known information, as the arithmetical mean of three transactions that are deemed to be similar.

### Investment incentives

- Recently there has been development in the area of state aid schemes, in almost all sectors and for different categories of companies.
- For SMEs active in the tourism and related sectors, the overall budget for the scheme is RON 426.25 million (approx. EUR 119 million) for the whole duration of the scheme (up to year 2013). Subject to several eligibility criteria, the beneficiaries of the aid can be SMEs active in the tourism and related sectors, as well as partnerships between SMEs and local authorities or intra-community development associations.

The value of the investment should be in the range of EUR 200,000-25,000,000. For modernising/extending an investment, the maximum value of the investment should not exceed EUR 5,000,000. The amount of aid that can be granted to an individual project varies on a case-by-case basis and the maximum intensity level ranges from 50% to 70% of the eligible costs, provided that the applicant's minimum contribution is observed (the minimum contribution ranges from 30% to 60% of the eligible costs).

- The other state aid scheme has the purpose of bringing Romania's manufacturing processes to European level. Subject to several eligibility criteria, state aid may only be granted in specific areas (e.g. the drilling industry, processing industry, water distribution, sanitation, waste management, decontamination activities, construction)

and for specific activities (e.g. expansion and modernisation, the acquisition of new technology, equipment and know-how, and innovation in manufacturing processes and products). The maximum amount of an individual grant is of EUR 5 million and cannot exceed the state aid intensity level (i.e. 40% for the Bucharest and the surrounding county of Ilfov area and 50% for the rest of the country). The state aid scheme does not apply to large investment projects, or to investments which have already started before the funding contract with the state aid provider is signed.

- The third state aid scheme aims at encouraging SMEs which process agricultural products, with the purpose of obtaining food products other than those covered in appendix 1 to the CEE treaty; encouraging SMEs conducting processing activities on agricultural products, with the purpose of obtaining and using renewable energy sources and biofuels; and encouraging micro-enterprises engaged in the primary processing of wood and non-wood forest products. The scheme will apply from 30 March 2008 to 31 December 2008. In the case of agricultural products, the maximum state aid per beneficiary is EUR 3 million/project, and the gross intensity cap is 40% for Bucharest and the surrounding county of Ilfov and 50% for the rest of Romania. In the case of the state aid scheme to encourage micro-companies in the fields of the basic processing of wood and non-wood forest products, the maximum state aid per beneficiary is EUR 2 million/project, and the gross intensity cap is 40% for Bucharest and the surrounding county of Ilfov and 50% for the rest of Romania.

## Indirect taxation

### VAT

- Since 1 January 2008, VAT simplification measures (i.e. reverse-charge) are no longer applicable for supplies of buildings or building land, or for construction assembly works. Transitional measures have therefore been implemented to enable simplification measures to be applied for ongoing contracts for the supply of such goods that were concluded before 1 January 2008.
- VAT is no longer applicable for stolen or lost goods, provided companies can present evidence from the police that the goods were stolen or lost and the evidence is accepted by the insurance companies which insured the goods.

- Transitional measures have been implemented for capital goods that are not entirely used for operations that allow a VAT deduction right and for which an adjustment of five or twenty years was applied in 2007. The new amendments mean that the VAT adjustment related to these capital goods must be performed as a one-off for the remaining value, with this adjustment being entered in the VAT return for December 2008.
- VAT deducted for capital goods has to be adjusted during the adjustment period (five years for fixed assets and 20 years for immovable goods) and if these capital goods have been acquired, produced, modernised or transformed after the EU accession date, irrespective of whether their normal period of use has expired or not.
- The applicability of VAT exemptions for financial/banking operations and insurance operations was clarified (e.g. the taxable base for factoring is expressly mentioned, VAT exemption is applicable for the management of mandatory and voluntary private pension funds, the management of investment trusts and for claim guarantee pools).
- Outsourced financial services may benefit from VAT exemption if they fulfil the definition of VAT-exempt financial services.
- Taxes for advertising and publicity services, hotel tax, the cinematographic fund contribution and tax on health-damaging activities are not subject to VAT, regardless of the person issuing the invoice.
- The fiscal authorities allow VAT deductions for input VAT if the justifying documents held by companies are incomplete or incorrect, provided these documents are corrected during a tax inspection.
- Companies established outside the European Union and not registered in Romania can benefit from a VAT refund in Romania if a reciprocity agreement is concluded between Romania and the company's country of residence. Names of such signatory countries are to be published on the official website of the Ministry of the Economy and Finance.
- The timeframe for issuing invoices is reduced to the fifteenth day of the month following the month in which the taxable supply is made.
- Invoices for advanced payments cashed/paid while performing intra-community supplies/acquisitions of goods have to be included in the VAT reports.

## Customs duties

- Technical norms regarding the granting of Authorised Economic Operator (“AEO”) status entered into force on 1 January 2008. AEOs benefit from simplifications regarding customs inspections, obtaining customs authorisations and performing customs formalities. Qualifying conditions have to be met to obtain AEO status.

## Excise duties

- As of 1 January 2008, the retail price-based excise duty rate on cigarettes has been increased from EUR 41.5 per 1,000 cigarettes to EUR 50 per 1,000 cigarettes (i.e. EUR 20.89 per 1,000 cigarettes plus 27% levied on the maximum retail price). The minimum excise duty rate was set at EUR 39.50 per 1,000 cigarettes.

## Environmental fund

- The European Pollutant release and Transfer Register has been implemented in Romania by Government Decision. Companies have to report the amounts of pollutants released and off-site transfers of hazardous/non-hazardous waste annually to the National Environmental Protection Agency if certain thresholds are exceeded.

## Legal and other developments

### Accounting regulation

- An Order of the Ministry of Economy and Finance introduced several changes to the Accounting Regulations, in accordance with EU Directives:

- Romanian permanent establishments of legal entities resident abroad are obliged to prepare their annual financial statements and periodic accounting reports as required by the Law of Accounting Regulations.
- The accounting treatment is to be applied to lease-back transactions is specified and depends on whether the transaction can be categorised, given the contractual clauses, as financial leasing or as operational leasing.
- The cost of a tangible fixed asset can also include, in connection with a related provision, the estimated future expenses for dismantling and relocating the fixed asset as well as for the restoration of the site on which the fixed asset was installed. The inclusion is allowed if such costs can be reliably and credibly estimated and if the entity has an obligation to dismantle, relocate and restore the site.
- Assets with long production cycles which are meant for sale (e.g. buildings) qualify as inventory for accounting purposes.
- A distinction is made between revaluations of assets held at the end of the year, which are made for the purpose of reflecting the fair value of assets in the books, and evaluations of assets performed for reorganisation purposes (mergers and spin-offs), which are not to be entered in the books. Thus, evaluations of assets performed for reorganisation purposes are only to be used in settling exchange rates for all balance sheet items.
- The rules to be applied when accounting for gains and losses from transactions with own equity (shares, stocks) are now set out in detail and new accounts are introduced into the General Chart of Accounts.

### Other

- The procedure for authorising individuals to carry out independent activities has recently been changed. The two main changes are as follows:
  - Firstly, persons that can carry out independent activities are classified into three categories: freelancers, private enterprises and family enterprises.
  - Secondly, the authorisations are now issued by the Romanian Registrar of Companies (previously it was issued by the City Halls).

# Russia

## Dividends from particular territories will not qualify for tax exemption in Russia

The Russian Ministry of Finance has published a list of offshore zones for the purpose of calculating tax on dividend income. Dividends that come from these states and territories cannot be taxed at the 0% rate in Russia, even if the “strategic investment” condition is satisfied (generally, dividends received from “strategic investment” are exempt from Russian income tax). The list comprises 41 states and territories, including the Bermuda Islands, the British Virgin Islands, the Cayman Islands, Cyprus, Gibraltar, Malaysia, and the United Arab Emirates.

## Corporate taxation

### Double Tax Treaties

- Russia ratified a Double Tax Treaty between Russia and Mexico in March 2008.

## Legal and other developments

### Labour code

- The Labour Code has been supplemented with a new section on employing professional athletes and coaches. This section sets additional grounds for employment contract termination that may only be applied for these specific employees. Additionally, under this new regulation, professional athletes can terminate their contracts simply by paying their employer a fine if such a payment was provided for in the labour contract.



# Serbia

## A step forward for Serbia towards EU

On 29 April 2008, the EU signed the Stabilisation and Association Agreement (SAA) with Serbia, as the instrument of the Stabilisation and Association Process (SAP). The ultimate goal for both parties is to see Serbia become an EU Member State. On the trade side, the SAA effectively represents the free trade agreement (FTA) between the EU and the signatory party.

Since 2001, Serbia has benefitted from the Autonomous Trade Measures (ATMs), unilaterally granted by the EU. ATMs provide preferential status to products of Serbian origin when imported into the EU. Preferential Serbian origin is determined according to the Pan-European preferential rules of origin. Access to the EU market on the basis of the ATMs, i.e. import free of customs duties and quantitative restrictions, is granted without the equivalent obligation to open Serbian market towards the EU. ATMs also contain certain exceptions to this preferential status, and these encompass certain fish products, agricultural products, baby-beef, and other products. ATMs are enacted to be in force until 31 December 2010.

When the recently signed SAA comes into force, preferential trade will become two-way, i.e. obligation to open markets will be reciprocal. In the maximum period of six years from the day when the SAA comes into force, EU and Serbia should ensure establishment of the free trade zone – Serbia to start, and EU to continue with abolishment of customs duties and quantitative restrictions for most of the products, with certain exceptions. Preferential scope should become wider than that provided by the ATMs. This process is agreed to flow rapidly on the EU side, whilst in Serbia it will be done more gradually.

For the SAA to come into force it is necessary that national parliaments of all EU Member States ratify it. Some of the countries might not do so in the nearest future for political reasons i.e. until they are satisfied with Serbia achieving full cooperation with the Hague Tribunal. Nevertheless, certain provisions of the SAA, in particular those relating to the free movement of goods as well as the relevant provisions on transport, which effectively enable preferential trade, will start to apply as of the date when Interim Agreement on Trade and Trade Related Matters between EU and Serbia becomes applicable, which should be 1 July 2008.

When the SAA comes into force, ATMs will be derogated in those parts where the SAA provisions are more favourable. Only the bilateral FTA Serbia has with EU, i.e. the FTA on trade with textile products, will remain in effect after the SAA comes into force.

## Corporate taxation

### Corporate tax

- There have been no relevant changes recently in Serbia in respect of corporate income tax legislation. However, the Ministry of Finance has issued several opinions aiming to regulate in more detail certain aspects of transfer pricing rules and application of Double Tax Treaties.

### Double Tax Treaties

- In order to be entitled to apply provisions of a relevant Double Tax Treaty, a taxpayer should present to the Tax Authorities the following documents:
  - the tax residency certificate of the recipient of income sourced in Serbia, issued by the authorised body of the recipient country with which Serbia has signed the Double Tax Treaty; and
  - the proof that the recipient of income sourced in Serbia is the beneficial owner of income.
- The Ministry of Finance took a step forward in determining what would be sufficient proof of a beneficial ownership status in respect of Double Tax Treaty applicability. According to the opinion, a commercial agreement between a resident and a non-resident recipient of income is regarded as relevant, but not sufficient proof. The Ministry of Finance did not elaborate further on the type of documents that should be considered as sufficient proof. The Ministry of Finance only stated that a non-resident may present any document that directly or indirectly confirms his/her beneficial ownership status.

### Transfer pricing

- The Ministry of Finance issued an opinion clearly stating that a taxpayer in Serbia is obliged to present transactions with related parties (if any) in its corporate tax return even when no adjustments to the taxable base is made, i.e. the transactions between related parties are carried out at arm's length.
- In order to determine if an adjustment to the taxable base is necessary, a comparable uncontrolled price method should preferably be used. Where not possible, a reasonable margin (cost plus) or a resale price method could be used.

- The transactions between related parties should be substantiated with proper documents and all relevant circumstances should be taken into account when comparing transactions carried out between related and third parties such as payment terms, guaranties, discounts, distribution methods, etc.

## Indirect taxation

### VAT

- There have been no significant changes in Serbia's VAT legislation in 2008. Serbia's Ministry of Finance issued several rulings with the intention of further clarifying uncertainties which arose in the interpretation of the VAT Law.
- A taxpayer providing mediation services related to supply of goods dispatched from abroad to customers outside of the Republic of Serbia is not obliged to charge VAT on the fee received for these services, since the supply and accompanying mediation service is beyond the scope of Serbian VAT.
- Based on the VAT Law, insurance and reinsurance services including supporting services of the insurance intermediaries and agents are VAT exempt without right to deduct input VAT. However, if the insurance agency performs assessment of claims related to goods not initially included in the insurance policy, VAT should be charged on the remuneration received in this respect.
- Success fee represents part of the total remuneration received for provided consulting services and consequently should be included in VAT base.
- The free of charge service of using a taxpayer's equipment (e.g. ice-cream coolers) by customers is subject to VAT.
- In order to register/deregister for VAT in Serbia, supplies made by a taxpayer which are beyond the scope of VAT should not be taken into account for determination of total supplies made in the relevant period.

## Legal and other developments

### Foreign trade transactions law

- The National Bank of Serbia (NBS) amended a Decision on the manner and conditions for use of financial loans from abroad by decreasing the repayment period from 13 to 12 months.
- The NBS passed an amendment to the Decision on terms and manner of payment in cash in RSD for legal and physical entities conducting business activity in Serbia. As per this amendment this Decision is also applicable to non-resident legal entities conducting business activity in Serbia.
- NBS passed the Decision on opening, conducting and transferring individual accounts of members of voluntary pension funds, which prescribes in detail the procedure of opening and conducting these accounts.

### Labour code

- The General Collective Agreement was enacted in April 2008. It was concluded at the state level, for all branches/areas of employment in the territory of the Republic of Serbia. It was signed for a period of three years, between the Representative Association of Employers on one side and the Association of Independent Syndicates of Serbia and the United Branch Syndicates "Independence" on the other side, with the goal of regulating the rights and obligations between employers and employees in the Republic of Serbia.

### Other

- The new Law on Distribution of Free Shares and Pecuniary Compensation to Citizens in the Process of Privatisation was enacted in January 2008. This Law envisage equal distribution of free shares in state-owned companies to all citizens of the Republic of Serbia over 18 years of age in 2008. All Serbian citizens are to register themselves for these shares by 30 June 2008. These shares will be tradable on the stock market as of 2009.
- The Ministry of Finance has prepared new amendments to the Securities Law, of which the most important is the possibility of issuing new shares simultaneously with the sale of the existing shares of the same issuer.

# Slovakia

## Cross-border mergers

An amendment to the Slovak Commercial Code came into effect on 1 January 2008. One of the main aims of the amendment was the implementation of the EU Directive on cross-border mergers and amalgamations.

The Slovak Commercial Code applies to mergers or amalgamations of companies whose registered offices are in EU Member States, where the registered office of at least one of the merging entities is in Slovakia. The rules for cross-border mergers and amalgamations apply to all types of legal entities recognised under Slovak law.

Under the Commercial Code, cross-border mergers and amalgamations are possible between companies with similar legal forms. The courts will decide whether merging companies have similar legal forms and whether all the conditions for entering the successor company of the merger in the Slovak Commercial Register have been met.

A cross-border merger generally involves the following basic steps:

- drafting a contract on the cross-border merger, which must include detailed information about various features of the merging companies and the implications for employees;
- publishing, in the legally prescribed manner, the most important data related to the merger, at least 60 days before approval of the draft merger contract;
- approval of the merger by the General Meetings of the shareholders of the companies involved;
- taking certain steps to protect shareholders who voted against the cross-border merger;
- enabling creditors to enforce their rights; and
- issuing a notary certificate attesting proper completion of the pre-merger actions and formalities before the merger is entered in the Slovak Commercial Register.

A cross-border merger will come into effect on the day the wound-up Slovak company is deleted from the Commercial Register and the new company is entered in the Commercial Register. Both acts will occur on the same day if the new company has its registered office in Slovakia. Otherwise, the Slovak Commercial Register will delete the Slovak merging company after receiving binding confirmation of the merger from the appropriate foreign register.



# Slovenia

## Tax deductibility of takeover financing loan interest Corporate taxation

The Slovenian Tax Authorities have issued an opinion regarding the tax deduction of the costs of financing a takeover. It is relevant to a scenario in which company A raised a loan to purchase a 100% share in the capital of company B, and later on company A merged with company B and the latter took over all the receivables and liabilities, including the liability of paying off the loan. The taxpayer asked whether the cost of the interest on the loan was deductible by company A before the merger, and whether this was so for company B after the merger.

The Tax Authorities advised that the transactions should be treated separately, i.e. the tax treatment of the loan received by company A should be considered separately from the tax treatment of the loan pushdown to company B after the merger. They stressed that as long as company A holds the shares of company B, specific provisions in relation to the holding companies should be taken into account. According to Slovenian tax legislation, dividends received are normally exempt from taxation unless they are received from certain low-tax jurisdictions. However, expenditure relating to these dividends, including financing and management costs, is not deductible in a lump sum which is equal to 5% of exempt dividends. The Tax Authorities therefore concluded that the deduction of interest costs is regulated through the lump sum, which means in practice that a taxpayer claims a tax credit for the whole amount of interest and adds back 5% of the dividends received to the tax base.

After the merger of company A with company B, the specific provisions for holding companies cannot apply and thus the general provision on the tax deduction of expenditures should be considered. In this particular case, the Tax Authorities came to the conclusion that the downstream merger which resulted in the change of ownership of company B did not change the conditions for performing the activities of company B. However, interest does not represent expenditure necessary for the gain of taxable income by company B and is not a direct condition of performing the activities of the company. They furthermore advised that the purpose of the loan was to enable the owners of company A to become owners of company B. Therefore, the interest and other costs relating to the loan are not tax-deductible by company B.

We must stress that the above opinion does not have the status of a binding ruling in Slovenia, although in practice it gives guidance to tax inspectors and taxpayers. It should also be noted that we have supplied the Tax Authorities with our alternative interpretation of such a takeover structuring, which does not support their opinion. We have, however, noticed that the Tax Authorities' opinion has already had an effect on the structuring of takeovers in Slovenia as well as on debt push-down strategies.

## Double Tax Treaties

- New Double Tax Treaties with UK and Northern Ireland came into force on 28 May 2008, and Slovenia has recently ratified the Treaty with Italy.

## Transfer pricing

- Slovenia applies the arm's length principle. Transfer pricing rules with requirements for transfer pricing documentation have been in effect in Slovenia since 2005. A list of the required documentation is provided in the Tax Procedure Act. The provisions of the Tax Procedure Act on transfer pricing follow the EU Code of Conduct on transfer pricing documentation for associated enterprises in the European Union.
- Transfer pricing documentation has to be made available for tax audit immediately at the request of the tax authorities. Penalties may be imposed if the documentation is not made available within 30-90 days of the tax authority's request, depending on the nature and volume of documentation. Certain information should be disclosed with the submission of the tax return, in particular disclosure of inter-company loans and inter-company transactions, with details of the total amounts and the related parties involved. Notwithstanding the arm's length principle, in the case of transactions between related resident companies, the tax base can be neither increased nor decreased unless one of the resident companies is in a favourable tax position, e.g. has tax losses carried forward.

## Deferred tax

- Deferred tax is caused by temporary differences between the accounting treatment and corporate income tax treatment. It is recognised on various items, including tax losses, differences between tax and accounting depreciation or impairment, provisions and restructuring.

## Legal and other developments

### Business transformations

- The amendments of the Slovene Banking Act came into force on 5 January 2008. According to the amendments, Slovene banks should not grant loans for the acquisition of (business) shares if the loan is to be secured with the shares of the target company.
- The amendments to the Slovene Takeover Act came into force on 5 January 2008. According to the amendments, the acquirer of the shares must prove to the Securities Market Agency that payment of the securities which are the subject of acquisition were not secured with the securities or any assets of the target company.

# Ukraine

## WTO membership

On 16 May 2008, Ukraine joined the World Trade Organisation (WTO).

Ukraine's major commitments under the WTO accession protocol are:

- Lowering customs duties to an average of 10.66% for agricultural products and 4.95% for industrial goods, including civil aircraft, construction equipment, distilled spirits, certain types of fish, pharmaceuticals, certain chemicals and petroleum oils, medical equipment, wood-based materials, wood-pulp and paper, certain yarns and fabrics, certain base metals, steel, information technology products, furniture and toys. For many goods, customs duty will be cut to zero.
- Allowing access to foreign service providers, on a non-discriminatory basis, in 11 “core” service sectors: business services, communication services, construction and related engineering services, distribution, educational and environmental services, financial services (insurance and banking), health and social services, tourism and travel, recreational, cultural and sporting services, and transport services.

The non-discrimination clause means that, as a result of accession, foreign banks and insurance companies, etc., should be entitled to establish full branch offices in Ukraine. However, there will need to be substantial changes to other laws to allow this.

WTO membership should boost economic growth and attract more foreign investment to Ukraine. It will also speed up negotiations on a free trade agreement with the EU.

The most significant effects of WTO accession will be seen in the long term.

## Corporate taxation

### Corporate tax

- From 1 January 2008, the previous practice of limiting losses carried forward to one year has been removed. Unused tax losses generated in 2003-2006 are potentially available for offsetting in 2008. However, the tax authorities have expressed the opinion that the taxpayer has no right to use losses incurred before 1 January and not used due to limitations introduced in previous years. This opinion is solely based on a literal interpretation of the Corporate Profits Tax Law, and does not reflect the spirit of the tax law regarding losses carried forward.

## Indirect taxation

### VAT

- From 16 January 2008, the customs authorities terminated delaying VAT payments on imported goods by issuing promissory notes.
- From 1 April 2008, VAT payers must report their sales and purchase turnover, per buyer/supplier, to the tax authorities on a monthly basis.

### Customs duties

- From the date of accession to the WTO (16 May 2008), Ukraine is applying new (mostly reduced) customs duty rates on imported goods.

## Legal and other developments

### Other

- From 12 April 2008, a legal entity may issue bonds for an amount not exceeding:
  - triple the amount of its own capital (assets less liabilities); or
  - the amount of a security provided by a third party.
- Changes to the legislation on advertising have tightened the rules on advertising tobacco products and spirits.

# Uzbekistan

## New penalty system

The new Tax Code, which came into effect on 1 January 2008, sets a number of penalties, fines and interest that may be imposed if a taxpayer is found to have breached the tax regulations. Among other penalties, these include:

- Failure to register for tax purposes incurs a fine of up to 100 times the minimum monthly wage (currently, the minimum monthly wage is UZS 20,865, approximately EUR 10), but not less than 50% of the income (profits) gained as a result of such activities.
- The full amount of concealed or understated revenue from sales of goods and services is subject to confiscation.
- Late payment interest is charged at the rate of 0.05% of the outstanding liability per day;
- A 1% per day interest charge (but not more than 10% of the tax due) is imposed if a taxpayer fails to file a tax return by the prescribed deadline.
- Failure to maintain proper bookkeeping or inadequate maintenance of bookkeeping is subject to a fine of 1% of the sales turnover, but not more than 50 times the minimum monthly wage.
- Carrying out activities without the required license is subject to a fine of 100% of income (profits) gained from such activities, less taxes and mandatory payments already paid on such activities.

- If a supplier issues an invoice with VAT but is not the VAT payer, the supplier will incur a fine equivalent to 120% of the VAT amount shown in the invoice.
- Failure to use cash register machines as required by regulations when selling goods or providing services and failure to issue receipts, etc. as required by the regulations, incur a fine of up to 50 times the minimum monthly wage. If the offense is repeated within one year of the date when the first fine was imposed, a new fine of up to 100 times the minimum monthly wage is imposed.
- The use of land outside the boundaries defined in the title deeds of a given plot of land incurs a fine of 2% of the annual land tax for legal entities, and 1.5% for individuals.

If a taxpayer (legal entity) disputes the assessment of tax liabilities and financial sanctions, a claim can be submitted to the higher tax authority, i.e. the State Tax Committee.

A taxpayer may also file a claim with the court which has the effect of suspending execution of the tax liabilities and sanctions in dispute; these can be executed, if at all, by court decision, which has to be issued within 30 days. When filing a claim with the court, the taxpayer should notify the tax authorities accordingly.



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