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Tax Newsletter  
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Central Europe





# Tax news in Central European countries

## Albania

### I. VAT

#### VAT law amended to expand scope of exempt supply

Law No. 10 215, approved on 21 January 2010, made the following changes to the exempt supply rules in the Albanian VAT law:

- A new article provides that, as from 1 October 2010, the supply of educational services by public and private institutions is an exempt supply.
- Effective from 4 February 2010, the supply of services outside Albania, by a taxable person whose place of economic activity is in Albania, or for an individual, whose place of residence is Albania, is an exempt supply.

#### The Council of Ministers decision no. 55, dated 3 February 2010 amended the existing VAT Instructions in regards to the online declaration rules.

The rules related to the declaration of VAT books, sales and purchase books and the partial tax credit have been changed.

- Taxpayers registered at the Regional Directorate of Large Taxpayers must make an online declaration for the purchase and sales books. The declaration forms can be downloaded from the tax authorities' web site and must be submitted/uploaded by the fifth day of each month. The online declaration requirement became effective on 1 January 2010 for VIP taxpayers, 1 March 2010 for general VAT payers and on 1 July 2010 for small businesses.
- A VAT credit is granted on the purchase of gas up to a specified amount. The credit is available in respect of gas purchased for construction (up to 25%), trade (up to 3%) and transport (up to 18%).

#### Minimum threshold for VAT registration

In decision No. 149 dated 3 March 2010 the Council of Ministers stated that the minimum threshold for VAT registration for taxpayers providing the following professional services is ALL 2 million per calendar year:

- a) Lawyers and notaries;
- b) Doctors, dentists (including specialists), pharmacists, nurses, architects, engineers, veterinarians, agronomists, midwives and economists;
- c) Chartered accountants and professional accountants; and
- d) Real estate assessors.

### II. Tax procedures

#### Law on Tax Procedures

According to amendments made at the beginning of 2010, all employers are required to notify the tax authorities of newly hired employees (including unpaid employees) 24 hours before the individual starts work. Failure to submit the declaration will result in the employer being liable for unpaid social and health insurance contributions and a penalty of ALL 50,000 in the case of a small business and ALL 100,000 in the case of a taxpayer registered for VAT purposes. The employer also must notify the tax authorities within 10 days of the resignation of an employee; otherwise, the contributions will be calculated up to the date the declaration is submitted.

### III. Social and health insurance contributions

The following changes have been made to the social security and health contribution:

- As from 2 March 2010, self-employed individuals engaged in trade and service activities must pay social insurance and maintain a contribution recording book that includes an entry for pension contributions.
- As from 1 July 2010, the minimum monthly wage for purposes of calculating social and health insurance contributions is ALL 16,820 and the maximum monthly wage is ALL 84,100.

#### IV. National taxes

To discourage individuals from purchasing second-hand cars, the seller of a used car is required to pay a tax, calculated as follows: Number of years in use x 0.5 x cubic centimeters x 20 (the co-efficient for diesel cars is 25). The new tax is applicable as from 19 July 2010.

#### V. Excise taxes

The excise tax on a number of items was increased as from 17 July 2010, as follows:

Code	Description	Excise Tax before July 17 <sup>th</sup> , 2010	Excise Tax after July 17 <sup>th</sup> , 2010
09 01 11 00	Unroasted coffee (decaffeinated and caffeinated)	70 ALL/kg	30 ALL/kg
09 01 12 00			
<b>II</b>	<b>Fruit juices, water and soft beverages</b>		
22 09	Fruit and vegetable juice (non-fermented, non-alcoholic), with or without sweetener	2 ALL/liter	0 ALL/liter
22 02	Mineral and sparkling water, with sweeteners or flavors and non-alcoholic beverages, excluding fruit juice	2 ALL/liter	0 ALL/liter
27 10 19 21	Fuel type coal oil	0 ALL/liter	20 ALL/liter
27 10 19 51	Crude oil as fuel	13 ALL/kg	20 ALL/kg
Until 27 1 19 69			
27 15	Lacquer tarry	0 ALL/kg	5 ALL/kg
<b>29 01</b>			
29 02	Acyclic hydrocarbons and cyclic (ethylene, benzene, Toluol, Ksilol)	5 ALL/kg	20 ALL/kg
40 12	Second-hand pneumatic tires	0 ALL/kg	100 ALL/kg
<b>V</b>	<b>Fireworks</b>		
36 04 10 00	Fireworks	0 ALL/kg	200 ALL/kg
36 04 90 00	Other	0 ALL/kg	200 ALL/kg
<b>VI</b>	<b>Tires</b>		
40 11	New pneumatic rubber tires	0 ALL/kg	20 ALL/kg
40 12 (excluding 40 12 20 00)	Pneumatic dressed tires	0 ALL/kg	40 ALL/kg
40 12 20 00	Second-hand pneumatic tires	0 ALL/kg	100 ALL/kg

Code	Description	Excise Tax before July 17 <sup>th</sup> , 2010	Excise Tax after July 17 <sup>th</sup> , 2010
<b>VII</b>	<b>Piles and primary bateries and electric accumulators</b>		
<b>85 06</b>	Piles and primary batteries	0 ALL/kg	200 ALL/kg
<b>85 07</b>	Electric accumulators	0 ALL/kg	20 ALL/kg
<b>VIII</b>	<b>Packaging</b>		
	Plastic packaging	0 ALL/kg	100 ALL/kg
	Glass packaging	0 ALL/kg	10 ALL/kg
	Mixed packaging	0 ALL/kg	20 ALL/kg
<b>IX</b>	<b>Incadescent lamps</b>		
<b>85 39 21 92</b>	Over 100 V	200 %	0
<b>85 39 21 98</b>	Not over 100 V	200 %	0
<b>85 39 22 10</b>	Reflector lamps	200 %	100 ALL/pcs
<b>85 39 22 90</b>	Other	200 %	100 ALL/pcs
<b>85 39 29 92</b>	Over 100 V	200 %	100 ALL/pcs
<b>85 39 29 98</b>	Not over 100 V	200 %	100 ALL/pcs



## Bulgaria

### Transfer Pricing Manual

The National Revenue Agency published a “Transfer Pricing Manual” in February 2010 that provides guidance on a wide range of transfer pricing topics, such as documentation requirements and intragroup services. Most of the Manual is based on the 1995 OECD Transfer Pricing Guidelines, but it also includes guidance from the Bulgarian tax authorities. The Manual provides more predictability to taxpayers at a time when the tax authorities are becoming more active in the transfer pricing area. Companies that are part of a multinational group should ensure that their headquarters is aware of the Manual and take appropriate action to bring their transfer pricing policies in line with the Manual.

### Withholding tax refund

As from 1 January 2010, foreign entities resident in an EU/EEA Member State are able to claim a refund of a portion of the withholding tax paid in Bulgaria for the calendar year. Eligible foreign entities may claim a refund equal to the difference between the withholding tax paid on a gross basis and the tax that would have been payable on the same income under the Bulgarian corporate income tax rules (i.e. after deducting expenses related to the income). Companies that are unable to (fully) recover Bulgarian withholding tax under a tax treaty or domestic rules should consider this tax refund opportunity.

### Beneficial ownership

The Bulgarian tax authorities have become increasingly focused on the criterion for “beneficial ownership” of income when determining whether benefits should be granted under a tax treaty and recently proposed legislation, which is expected to be effective as from 1 January 2011, contains specific rules for determining whether a foreign company is the beneficial owner of income. Foreign companies deriving Bulgarian-source income should analyze their beneficial ownership status in light of the new practices and impending rules, and if necessary, take appropriate measures to mitigate potential withholding tax risks.



## Croatia

### Corporate and Personal Income Tax Acts

The Croatian government published a number of amendments to the Corporate Income Tax Act and the Personal Income Tax Act, which apply as from 1 July 2010. The most important changes are as follows:

#### Corporate income tax

##### **Deductibility of voluntary pension insurance**

**premium payments:** An employer may deduct voluntary pension insurance premium payments made on behalf of its employees (not taxable under the enacted changes to the Personal Income Tax Act) up to HRK 500 monthly (total HRK 6,000 annually).

##### **Deductibility of non-business activity-related**

**expenses:** Expenses that not related to or arising from a taxpayer's business activities may not be deducted for tax purposes. This provision is not new, as it already existed in the corporate income tax regulations, but the new regulations rephrase this provision with the intent of providing additional stress on its importance.

##### **Deductibility of personal costs of company executive, employee and shareholder costs:**

Personal costs of employees, shareholders and executives that are declared as company expenses or hidden profit distributions are now deductible, because they are specifically taxable for personal income tax purposes. However, if personal income tax is not calculated on these non-business-related individual expenses, the taxpayer must increase its tax base for the expenses, including the relevant personal income tax and social security contributions. Expenses not related to the taxpayer's business activities or not resulting from the business activities are nondeductible. This provision is not new, as it existed before the changes to the corporate income tax rules, but, as in the previous paragraph, the wording has been rephrased to place additional emphasis.

**Advance dividend payments:** If annual profits of a resident company are insufficient to cover advance dividend or profit share payments, and the advance payment is not refunded to the enterprise, the difference between the actual annual profits and the advance payment is regarded as taxable personal income in the hands of the shareholders.

**Unused annual leave deductibility:** Unused annual leave provisions are deductible.

**Long-term tangible assets:** Assets acquired for less than HRK 3,500 (up from HRK 2,000) can be treated as expenses and do not need to be depreciated over a certain period.

##### **Deductibility of vessels, aircraft and holiday home**

**expenses:** Vessels and aircraft expenses are deductible only if they generate annual income of at least 7% of their acquisition value, or, if leased, at least income equivalent to the leasing costs. Holiday home expenses are deductible only if they generate annual income of at least 5% of the acquisition value. Expenses include depreciation and costs related to use of the assets.

##### **Scope of transfer pricing documentation**

**requirement:** The transfer pricing documentation requirements now apply to domestic transactions if one of the parties is entitled to tax relief or the use of loss carryforwards. In other words, the burden of proving the arm's length nature of intragroup transactions is shifted to the taxpayer even in domestic transactions if one of the parties can realize a tax benefit from the transaction (including financing transactions).

**Restrictions on use of loss carryforwards:** To prevent trading in losses, enterprises that change their legal status or materially change their business activities (within the past two years) may not use previous loss carryforwards. Further, a change in ownership during a calendar year of 50% or more will trigger the disallowance of loss carry forwards for that year. Enterprises changing their status to avoid redundancies or to "recover" are exempt from these restrictions, although the law does not define when redundancies are being avoided or what constitutes a recovery.

##### **Withholding tax on services from tax havens:**

A mandatory 20% withholding tax applies to services paid to entities located in countries that have an average corporate tax rate of less than 12.5%, except for EU member states.

**Mandatory electronic filing:** Mid- and large-sized enterprises must file their annual tax returns electronically.

## Personal income tax

**Tax rates:** A number of new tax rates have been introduced:

- **Employment income:** 12% on monthly income up to HRK 3,600; 25% on monthly income of HRK 3,600–HRK 10,800; and 40% on monthly income over HRK 10,800. The base personal monthly deduction remains at HRK 1,800. The following transitional rates apply for 2010 filing purposes: 13.5% on income up to HRK 43,200; 25% on income from HRK 43,201 up to HRK 108,000; 30% on income from HRK 108,001 up to HRK 129,600; 37.5% on income from HRK 129,601 up to HRK 302,400; and 42.5% on income exceeding HRK 302,401.
- **Income from the refund of overpaid pension insurance:** 40% (reduced from 45%)
- **Income from property and property rights:** 12% (reduced from 15%)
- **Income from capital:** 40% and 25% (increased from 35% and 15%, respectively). The 40% rate applies to income from the use of assets and interest income, and the 25% rate applies to income from the issue of own shares or from participation in a share purchase plan.

**Tax allowances:** Various allowances have been abolished (except the general allowance and the R&D allowance). For 2010, individuals are entitled to a tax allowance up to HRK 6,000. For allowances to be accepted, receipts have to be paid before the Act came into force i.e. before 1 July 2010.

**Voluntary pension insurance premiums:** Voluntary pension insurance fund premiums paid by an employer on behalf of its employees are treated as nontaxable income to the employee up to HRK 500 per month, i.e. HRK 6,000 per annum.

**Filing requirements:** Resident individuals receiving foreign income are required to submit an annual tax return only if tax on the income was not paid at the time the income was received (i.e. on a monthly basis) or if the tax paid did not correspond with the individual's domestic tax liability. If a taxpayer is obliged to file an annual return (i.e. he/she is in receipt of income for which filing is mandatory), the taxpayer is required to report only the income for which a return is required and any employment income.

**Dividends:** Dividend and shares in profit payments must be made into the individual recipient's bank account.



## Czech Republic

### Court confirms deductibility of interest on loans to pay dividends

The Supreme Administrative Court (SAC) ruled on 25 March 2010 that interest on loans used to finance the payment of dividends is tax-deductible. This decision is in line with the position taken by tax practitioners in a long-standing dispute with the Ministry of Finance on this issue, specifically whether interest arising from the payment of dividends can be considered a cost incurred in acquiring, ensuring and maintaining taxable income. The SAC agreed with the taxpayer and held that the payment of a share in profit to the shareholder is directly connected with the business activities of a joint stock company because if the company did not pay dividends, its shareholders would not invest their resources in the company and the company would not be able to conduct business.

The time that a profit is generated and the time dividends are actually paid are not identical; the law does not state what a joint stock company should do with the profits before the general meeting of shareholders decides to distribute the profits or use them in another way. The SAC confirmed that this decision is fully within the remit of the company, as well as the decision on resources (internal or external) that will be used for distributing the profits. According to the SAC, there is no reason why a company using external resources to pay dividends should be at a tax disadvantage compared to a company using internal resources to pay dividends.

In conclusion, it can be stated that interest and other costs legitimately incurred by a business in connection with the payment of shares in profit (dividends, in the case of a joint stock company) must be considered costs incurred in acquiring, ensuring and maintaining taxable income of the business under section 24(1) of the Income Taxes Act provided the decision to pay dividends is in compliance with the Commercial Code and other regulations.

The SAC did not opine on cases where a loan is also used for other operations that have an impact on a company's equity.

### Tax treaties

- The Czech Republic and Belarus signed a protocol to the existing treaty between the two countries in August 2010.
- The protocol to the tax treaty between the Czech Republic and Serbia and Montenegro was submitted to the Chamber of Deputies of the Parliament in September 2010



## Hungary

### 2010 interim tax law changes adopted by Parliament

The Hungarian Parliament adopted interim tax law changes on 22 July 2010.

#### Personal income tax

**Income that falls outside the tax regime:** The concept of 'income outside the tax regime' is introduced as from 15 August 2010 in respect of income derived from household jobs (e.g. cleaning, babysitting) carried out for individuals and paid out of their taxed income. Such income is exempt from both personal income tax (PIT) and contributions. Neither the "employer" nor the worker are subject to a tax filing obligation if the employer complies with its notification obligation and pays a registration fee of HUF 1,000 per month per worker. A default penalty of HUF 100,000, as well as the full imposition of PIT and contribution liabilities, will be imposed if the notification and registration requirements are not met.

**Converting the tax paid abroad and the revenue from abroad to HUF:** In converting revenue earned in foreign currency to HUF, a payer that is required to deduct a tax advance must apply the effective exchange rate published by the National Bank of Hungary (MNB) on the 15th day of the month preceding the month the revenue is earned. For the assessment of tax or a tax advance, a private individual can opt to apply that same rate. Tax paid abroad may be converted to HUF by an individual on the date of payment or - in accordance with former regulations - at the exchange rate quoted by the MNB that applied on the last day of the tax year.

#### Corporate income tax

**10% tax rate:** With a view to decreasing the tax burden, the scope of the 10% preferential tax rate is extended from a tax base of HUF 50 million to HUF 500 million and the applicability of the rate will not be based on the fulfilment of the former criteria.

Because the tax rate changes apply as from mid-year, i.e. 1 July 2010, the 2010 tax calculation should be made on a divided year basis. For a positive tax base between 1 January and 30 June 2010:

- The 10% rate is applied to a tax base up to HUF 50 million by those who meet the current criteria, which

must be apportioned due to the division of the year; and

- The 19% rate is applicable to taxpayers that do not meet the criteria for the 10% rate.
- For a positive tax base between 1 July and 31 December 2010:
- The 10% rate is applicable up to HUF 250 million without having to fulfil any criteria; and
- The 19% is applicable above HUF 250 million.

The rules in effect in the tax year of allocation must be applied for the utilisation of allocated reserves equal to the tax unpaid as a result of the 10% tax rate applied in 2008 and 2009.

**Local taxes:** As from 1 January 2011, the provisions of the Act on Local Taxes on community tax payable by private entrepreneurs and tourism tax on holiday homes of private individuals is repealed.

#### Duties

Direct relatives (including a family relationship based on adoption) of a deceased/donor are exempt from inheritance tax and gift duty. This change requires a modification to the inheritance and gift duty rate tables, although the limits and rates relevant for the individual groups remain unchanged. Group I includes spouses, adopted and foster children, step- and foster parents, Group II includes siblings and Group III includes all other persons.

As a new duty exemption, the transfer of shares in a domestic company that holds real property to an associated party is exempt from the duty on the onerous transfer of property.

#### Property tax

The act on the tax on certain high value property is repealed to abolish the tax payable on high-performance passenger cars, watercraft and aircraft. (The second part of the tax assessed and filed for 2010 need not be paid.) Thus, the Act on Motor Vehicle Tax is also amended to eliminate the provisions on the deductibility of tax paid on high-performance passenger cars from the company car tax. However, under a transitional rule, tax paid for Q2 of 2010 may still be deducted from the company car tax for Q2 of 2010.

### Special tax on financial institutions

An amendment to the Act on the Solidarity Tax and Contribution to Improve the Balance of General Government introduces a special tax on financial organisations. Financial institutions with closed financial statements for the business year on 1 July 2010 must assess and file a return for the special tax for 2010. The financial institution is required to assess and file its special tax liability by 30 September 2010 and pay the amount in two equal instalments by 30 September and 10 December 2010, respectively. Financial intermediaries are not included as taxpayers subject to the special tax.

The tax base and rate of the special tax are calculated on the basis of the financial statements for 2009 and differ depending on the type of financial institution, as shown in the table below.

Taxpayer	Tax base	Tax rate
Credit institution	Adjusted balance sheet total for 2009	0.15% up to HUF 50 billion and 0.5% above that
Insurance company	Adjusted fee for 2009	6.2%
Financial enterprise	2009 profit from interest, fees and commissions	6.5%
Investment company	Adjusted net revenue for 2009	5.6%
Stock exchange	Adjusted net revenue for 2009	5.6%
Commodity trader, venture capital fund manager	Adjusted net revenue for 2009	5.6%
Investment fund manager	Total of the net asset value of funds managed, as well as the value of petty cash and portfolio assets managed at the end of 2009	0.028%

Financial organisations with a business year other than the calendar year must assess the special tax base according to data from the last financial year closed with financial statements.

The special tax must be accounted for in the pretax profits for fiscal year 2010. On the above tax base, financial institutions are subject to a special tax liability in 2011 and 2012, the detailed rules of which will be stipulated by a separate legal Act.

### Tax treatment of sports activities

Amendments to the personal and corporate income tax and duty rules relating to sports activities were adopted on 22 July 2010. The modified rules grant a corporate income tax allowance for support provided in a tax year to a national association of a spectator team sport, a member of such an association (i.e. a sports company or sports club) that is active in the sport or a prominently public benefit organisation established with a view to developing a spectator team sport. The allowance is available in the tax year in which the support was granted (with certain restrictions) and the following three tax years. It should be noted, however, that because the allowance is subject to the approval of the European Commission, the new rules are applicable only to subsidies provided after the date the approval is granted. Significantly, the new rules expand the definition of a "sports field" for purposes of the Duties Act, which, accordingly extends the allowance for the development of infrastructure to school sports training and traditional Hungarian success sports (gyms, swimming), in addition to the five spectator team sports.

## Kosovo

### New VAT Law

A new VAT law that became effective on 1 July 2010 made significant changes to harmonize Kosovo VAT legislation with EU rules. The most important features of the new law are as follows:

- New principles for determining the place of taxable transactions;
- New principles defining a chargeable event and chargeability of VAT;
- New principles on the right to deduct input VAT;
- Abolition of zero rates;
- Introduction of exempt activities with and without a right to deduct input tax; and
- Introduction of the reverse charge mechanism;

The law affects nonresidents making both supplies and acquisitions in Kosovo.

**Taxation of foreign enterprises:** Under the new VAT law, foreign enterprises carrying out taxable supplies in Kosovo are required to register for VAT purposes and appoint a tax representative if the recipient of the supply is a taxable person in Kosovo, i.e. registered for VAT purposes in Kosovo. In all other cases, the reverse charge applies. The tax representative must be a Kosovo taxpayer and must guarantee the payment of tax. A separate administrative instruction sets out the requirements and documents that must be submitted to the Kosovo tax authorities when appointing a fiscal representative. The main requirement is that Kosovo taxpayer representing the foreign company must not have any outstanding tax liabilities. The tax representative must be authorized with a power of attorney from the foreign enterprise and it must submit an application to act as the tax representative and request that the foreign enterprise be registered as a VAT payer. The instruction also provides that the tax representative is liable for the payment of taxes, penalty interest and any other penalties in respect of transactions carried out in Kosovo and that it is jointly liable for the calculation and payment of foreign enterprise VAT.

**Place of supply of goods/services rules:** The new law is much more detailed on many issues and it clarifies the place of supply for certain services, in particular, for engineers, accountants and lawyers providing advice to nonresidents, with the result that no VAT is chargeable. There is also more clarity on the tax treatment of supplies of telecom services and software outside Kosovo, clarifications that are vital to enable Kosovo's services sector to effectively export services and compete in the international market. They are also important to foster development of potential investment in areas such as business process outsourcing, call centres, etc.

The definitions of taxable and nontaxable persons, the supply of goods and services and the transfer of business activity are broadened. The new law provides different treatment for supplies of goods depending on whether transportation services are included in the supply, the supply of goods on board ships, aircraft and trains, as well as a supply through a distribution system. Specific rules govern the taxation of services provided in connection with immovable property, transport and services related to special events.

Under the new VAT Law, a continuous supply of goods or services is considered as being completed in intervals of one month, with the result that the invoice for a continuous supply of goods or services must be issued at least once a month.

The concept of electronically supplied services has been introduced.

Included in the list of exempt supplies (i.e. supplies made without a right to deduct input VAT) are certain activities that relate to the public interest (e.g. hospital services, supplies of human organs, blood and mothers' milk, services rendered by dental professionals, services linked to welfare, tuition fees, spiritual and religious welfare, etc.). The following also are exempt from VAT: insurance and insurance-related services, the supply of postal services, fiscal and similar stamps and betting, lotteries and other forms of gambling.

The Minister of Economy and Finance is expected to issued further guidance on certain aspects of the new VAT law, but the law does not specify any time in which such guidance issued.

## Poland

### Personal Income Tax

On May 24 2010, the Polish Supreme Administrative Court (SAC) issued a decision on the taxation of medical packages offered by employers to their employees, an area that has been fraught with conflicting interpretations by the tax authorities, the courts and employers.

Employers have argued that providing access to private medical care via the granting of a medical package will not automatically result in taxable income for the employee, because in the case of a free-of-charge benefit the recognition of income depends on whether the benefit actually has been received, and employers generally have no knowledge as to whether an employee has benefited from the medical care. The tax authorities have taken the position that free-of-charge medical packages are comprised of both the medical services and the potential to benefit from private healthcare and, therefore, the employee receives taxable income at the time coverage is granted. Administrative courts have rendered conflicting decisions on this issue, sometimes ruling in supporting of employers and sometimes in support of the tax authorities.

According to the May decision of the SAC, medical packages that allow an employee to benefit from private medical care and that are not included within the scope of occupational medicine trigger additional income for the employee. The SAC concluded that medical packages have economic value, so the individual covered receives actual benefits. The Court emphasized that the free benefit is simply to ensure that the employee has access to private health services (i.e. the acquisition of rights to use the services), regardless whether the employee has actually uses the services. As a result, employer-provided medical packages that are not exempt from tax under article 21 of the Polish Personal Income Tax Law, constitute a free-of-charge benefit for the employee, the value of which should be recognized as employment income.

The SAC decision puts an end to the debate about the taxability of medical package benefits and should result in a uniform approach by the tax authorities and courts. The decision is important for employers that did not withhold and pay tax due on medical benefits provided in the past. Based on the SAC decision, the tax authorities can challenge employers that do not recognize the value of private medical packages as taxable income, and require that personal income tax be paid on such benefits for the past five years. The new interpretation also may have consequences for social security contributions as they are based on income for PIT purposes.

It should be noted that the SAC did not rule on how the amount of income arising for the employee as a result of a medical package is to be determined.

### Corporate income tax

The SAC issued an important decision on 25 February 2010 concerning the depreciation of fixed assets used on the basis of a "tooling agreement." The SAC held that a taxpayer is not entitled to take depreciation on equipment that was transferred to another party to carry out production for the taxpayer. The Court based its decision on the definition of fixed assets, specifically the requirement that fixed assets be used "by the taxpayer for the purpose associated with the exercise of its business" (emphasis added). According to the SAC, the taxpayer must physically use the assets to be entitled to take tax depreciation.

Since tooling arrangements are widely used in Poland, this decision may be used by the tax authorities to challenge the tax deductibility of write-offs taken by taxpayers in connection with equipment delivered to third parties on the basis of a tooling agreement.

## Romania

### VAT rate increase

On 1 July 2010 the Romanian government increased the standard VAT rate from 19% to 24%. The measure, implemented in a very short time, obliged many companies to adjust their IT systems virtually overnight.

### Registry of intra-community operators

By means of Emergency Ordinance No. 54/2010 that contains several measures to combat tax evasion, the government amended the Fiscal Code, imposing an obligation on persons that carry out intra-community operations after 1 August 2010 to register in the Registry of Intra-Community Operators. This measure was designed to provide tax authorities with an accurate evidence of persons carrying out intra-community operations. Taxable persons that have as a shareholder or administrator a person against whom criminal prosecution was initiated and/or who has a criminal record associated with intra-community operations are not eligible for registration. To register, taxpayers must submit criminal record certificates for all shareholders and administrators. Non-established VAT payers use a simplified procedure whereby the filing of the criminal records is not required.

Registration is required for taxable persons carrying out transactions with goods, as well as those receiving/providing services that they report in the EC List, e.g. recipients of consultancy or IT maintenance services provided by persons established in other EU member states.

### Transfer pricing

According to new rules that apply as from 3 August 2010, if an adjustment is made to a taxpayer's income to reflect the market value of goods and services, a corresponding adjustment also must be made to the income of the related party.

### Corporate tax

Effective 3 August 2010, temporarily inactive taxpayers and taxpayers that declare to the Trade Registry or the register maintained by the competent courts that no activities are carried out at the head office/ secondary office are exempt from the minimum tax. Stating 1 October 2010, the minimum tax has been eliminated.

The list of expenses deemed to be incurred for the purpose of obtaining taxable income now includes expenses for services relating to the efficiency, optimization, operational and/or financial restructuring of the taxpayer's activities.

The method to be used to avoid double taxation respectively the method described in a double tax treaty (i.e., credit method and the exemption method) is specifically provided.

### Income tax

The following changes also are effective as from 3 August 2010:

- Income earned from freelance activities that are regulated professions according to the law will be considered professional services, even if the activities are carried out under a contract for a company or other entity that derives income from professional services according to the law;
- Income received from private pensions funds are included in the pension income category, with the first RON 1,000 exempt; and
- When filing a tax return, a resident individual that derives income from another country must submit a document issued by the competent authorities of that other country declaring the income, as well as any tax paid in the other country. Documents issued by the employer or another payer of the income are no longer accepted.

### Income derived by nonresidents

Clarifications have been made to the taxation of Romanian-source interest income derived by nonresidents. As from 1 July 2010, income from interest relating to sight (overnight) deposits, current accounts, term deposits, certificates of deposits and other savings instruments made at banks or other Romanian authorized financial institutions, is subject to a 16% tax regardless of when placements, accounts, etc. were opened. Income from interest registered before that date is not taxed.

## Serbia

### Corporate income tax law

Changes to Serbia's Corporate Income Tax Law that became effective on 27 March 2010 have implications for both residents and nonresidents. Most notably, changes have been made to the rules governing the deductibility of expenses, the thin capitalization rules, the taxation of capital gains derived by nonresidents and the availability of tax incentives.

### Adjustment of revenue and expenses

- Advertising and promotional expenses are deductible up to 5% of total revenue, while business entertainment expenses are deductible up to 0.5% of total revenue (previously, advertising and promotion expenses, and business entertainment expenses were deductible only up to 3% of total revenue).
- The list of deductible long-term provisions is extended to include "all provisions prescribed in the law," and the expenses of long-term provisions for guarantees and other warranties are deductible on a cash basis (i.e. the actual amount paid).
- The write-off of receivables is deductible if certain conditions are satisfied, i.e. the receivables previously were included in the taxpayer's income, they were written off as uncollectible in the taxpayer's books and there is sufficient evidence, including evidence from a court, that the receivables could not be collected. At the same time, a deductible adjustment is allowed where receivables have been due for at least 60 days. The law specifies that, to be deductible, the write-off of receivables, for which an adjustment was made in the previous tax period, must satisfy the conditions prescribed for the direct write-off of receivables. Thus, it is not possible to write off previously adjusted receivables without tax consequences if the conditions for a direct write-off are not satisfied.
- Income arising from the releasing of unused provisions that were not deductible in the period in which they were created is not included in taxable income in the period in which the income arises.
- Expenses for impairment losses (below acquisition cost) may be deducted in the tax period in which the assets are disposed of, used or impaired due to force majeure. Previously, these expenses were not deductible.

- Expenditure for health, education, scientific, humanitarian, religious, environmental protection and sports purposes remain deductible up to 3.5% of the taxpayer's total revenue. However, a deduction is available only if the funds are paid to recipients registered in the above sectors and are used for the above purposes.
- The threshold for the deduction of cultural expenses is increased to 3.5% (from 1.5%) of total revenue.
- Severance and retirement payments are deductible in the year in which they are paid (previously, they were nondeductible).

**Loss and capital loss carryforwards:** Net operating losses may be carried forward and used to offset taxable income for up to five years (previously 10 years). Likewise, capital losses may be carried forward to offset future capital gains for up to five years (reduced from 10 years).

**Capital gains derived by nonresidents:** Major changes were introduced in the taxation of Serbian-source capital gains derived by nonresident entities.

Previously, capital gains derived by nonresident entities from the disposal of qualifying assets in Serbia (i.e. real estate, securities, shares) were subject to a withholding tax of 20% (unless the gains were exempt under a tax treaty). The tax was withheld at source by the Serbian resident payer at the time the income was paid. If the transaction was carried out between two nonresident entities, the capital gains could not be taxed -- such gains were outside the scope of Serbian taxation. In practice, resident entities that had to withhold capital gains tax on behalf of nonresident recipients encountered difficulties in complying with the law, primarily in establishing the exact amount of the gain and the acquisition cost of the assets.

Capital gains derived by nonresidents from the disposal of Serbian assets are now taxed based on a tax assessment, so that Serbian-source capital gains derived by nonresidents in transactions with Serbian residents and nonresidents are subject to tax. Nonresident entities deriving capital gains from the disposal of qualifying assets in Serbia are required to appoint a tax representative to file the tax return and pay tax based on the assessment issued by the tax authorities.

**Related party status:** The minimum shareholding for related party status is reduced to “50% and over,” rather than “over 50%” of participation/voting rights. A party is related to a taxpayer if it has control or significant influence on the business decisions of the taxpayer. Control for these purposes is ownership of 50% or more of the shares or individually the largest percentage of shares/stake. Influence on business decisions exists where there is control, as well as when a party related to the taxpayer holds 50% or more or individually holds the largest share of votes in the taxpayer’s management bodies.

**Foreign tax credit:** Serbian residents are entitled to a tax credit for foreign tax (direct and underlying) paid by a nonresident subsidiary on distributed profits/dividends. The carryforward period for the foreign tax credit is five years (reduced from 10 years). A credit for foreign tax on interest and royalties paid by a nonresident subsidiary to its Serbian parent company also has been introduced. The tax credit is limited to the amount of tax that would have been due on the interest and royalties in Serbia.

**Tax incentives:** Various changes were made to Serbia’s tax incentives:

- **Investments in fixed assets:** A taxpayer that invests in fixed assets used for its predominant business activities, business activities that are inscribed in the founding acts or stated in other acts that determine the business activities of the taxpayer is entitled to a tax credit equal to 20% of the investment, up to 50% of the assessed tax in the year of the investment (for small enterprises, the credit is 40% of the investment, up to 70% of the assessed tax). The tax credit is not available for investments in furniture, passenger cars, electrical appliances, etc. Unused tax credits may be carried forward for 10 years. If the taxpayer disposes of the assets within three years of the purchase date, it will lose the tax credit retroactively and will have to pay the under-stated tax.
- Under the amendments, a taxpayer that disposes of an asset for which a tax credit was used may no longer carry forward any unused tax credits related to the asset if the disposal takes place between three and 10 years from the purchase date. The taxpayer will lose the right to carry forward any unused credits in the year of disposal of the asset.

- A taxpayer can no longer use a tax credit for acquiring assets that are already in use in Serbia, although a tax credit will be granted for imported new or used assets, the purchase of new assets in Serbia and investment in real estate.
- Finally, the amended rules clarify that the right to the investment tax credit may not be transferred to another taxpayer even if there has been a change in status (e.g. merger, etc.). This change is consistent with the tax practice and interpretation of the tax authorities.

• **Tax credit for investments in specific industries:** A taxpayer whose predominant business activities are in specific industries (e.g. metal processing, agriculture, car production, textile manufacturing, etc.) are entitled to a tax credit equal to 80% of its investment. If the predominant business activity criteria is fulfilled, the tax credit will be granted for all activities listed in the founding acts. The credit is not limited and may be carried forward for 10 years. However, the tax credit does not apply to assets already in use in Serbia and the rules relating to the use of the general tax credit for investment in fixed assets also apply.

• **Tax incentive for large investments:** A taxpayer that invests RSD 800 million (up from RSD 600 million) in assets and employs 100 new employees is entitled to a 10-year tax incentive in proportion to the value of the new assets. The new rules specify that a contribution of assets by a founder to the capital of a company in accordance with the capital increase rules also qualifies as an investment (in which case, the assets are valued at their fair market value). Assets that previously were used in Serbia are not taken into account for purposes of this incentive and assets that do not meet the requirements to qualify as fixed assets for the tax credit for investment in fixed assets do not qualify for the incentive.

• **Investment in under-developed areas:** A taxpayer carrying out activities in an under-developed area (previously referred to as an “area of special interest”) is exempt from income tax for five years, provided more than RSD 8 million (increased from RSD 6 million) is invested in the assets used in the predominant business activities and business activities inscribed in the founding acts and the taxpayer employs at least five persons for an indefinite period

of time. The same rules as apply for the incentive for large investments regarding founder contributions, previously used assets and assets that do not qualify for the tax credit for investment in fixed assets apply to investments in under-developed areas.

- **Tax credit for new employees:** The tax credit for hiring new employees for an indefinite period of time is abolished.

**Tax period:** A taxpayer may request a tax year other than the calendar year. If approved, the tax period must be used for at least five years.

**Thin capitalization rules:** Significant changes were made to the thin capitalization rules, as follows:

- Interest and expenses on related party (i.e. companies with more than or at least 50% direct or indirect ownership are considered related parties) loans are deductible in the tax balance for a loan up to the amount of four times the taxpayer's capital (and 10 for banks (but not other financial institutions));
- A taxpayer's own capital for this purpose is the difference between the assets on which the taxpayer earns income and related liabilities, but the assets and liabilities are averaged on 1 January and 31 December of the current year; and
- Related expenses include any related loan charges and foreign exchange losses.

The Ministry of Finance is expected to issue guidance and/or a new form for making thin capitalization calculations by the end of 2010.

In addition to meeting the debt-to-equity requirement, the taxpayer must demonstrate that the loan was used to carry out a registered business activity (i.e. if the loan is used for non-business activities, the interest and any related expense will be nondeductible) and verify that the interest rate is at arm's length. As a result, as from 2010, in addition to showing that the debt-to-equity ratio is not exceeded, the interest rate on the portion of a loan that may be deducted under the thin capitalization rules must be confirmed by an appropriate transfer pricing benchmark. Furthermore, the carryforward of unrecognized expenses from a thin capitalization perspective is no longer possible.

### Law on Tax Administration and Tax Procedure

The following changes to the Law on Tax Administration and Tax Procedure became effective on 6 August 2010.

- As from 1 January 2011, penalty interest is calculated at the rate equal to the annual repo rate of the National Bank of Serbia, increased by 10 percentage points, by applying the compound method. Until the new rules come into effect, however, penalty interest will be calculated at the rate equal to the annual discount rate of the National Bank, increased by 15 percentage points, by applying the compound method.
- A taxpayer that filed a tax return with an error or omission may amend the return within the statute of limitations period. An amended tax return may be submitted twice for the same tax period. Previously, a taxpayer could submit only one amended return per tax period and it had to be filed within 12 months.
- A uniform five-year statute of limitations has been introduced for tax assessment and tax collection. The statute of limitations for tax assessment starts from the first day of the year following the year in which tax was to be assessed. The statute of limitations for tax collection starts from the first day of the year following the year in which tax liability was due to be paid.
- Before a tax audit is initiated, a taxpayer can, at its own initiative, declare a tax violation or an omission (as prescribed by law) and pay the tax due, increased by the amount of penalty interest. In such a case, the taxpayer will not be fined and the tax authorities will not commence any infraction proceedings
- A taxpayer that violates the same tax law within two years from the date it was convicted of a tax violation can be banned from carrying out its business activities for six months to three years.
- The residence certificate, as proof of tax residence status, is now issued by the organizational unit within the tax authorities, instead of the Sector for Fiscal System with the Serbian Ministry of Finance.

### Personal Income Tax Law

Changes to the Personal Income Tax Law (PIT Law) came into effect on 27 March 2010. The main changes include the reduction in some schedular income tax rates and changes to the rules governing the taxable base, as well as non-taxable thresholds and tax brackets for annual personal income taxation of foreign nationals and individuals assigned abroad. The deadline for filing a tax return for reporting foreign-source income and payment of withholding taxes on such income was extended.

**Tax exemptions:** The PIT Law prescribes tax exemptions/nontaxable amounts for commuting costs, per diems in the country and abroad, accommodation expenses and transport expenses incurred on business trips, when the employer covers the expenses for the employee. Under the changes, the tax exemptions/nontaxable amounts applicable to employees also apply to persons who do not have employee status, but who earn income that is subject to Salary Tax. Hence, they will apply to payments made to a director without the status of an employee who is engaged under a contract to fulfill the obligations of a director. Such directors receive remuneration that is taxable as salary. The exemptions also apply to individuals performing activities based on temporary and occasional work agreements.

**Independent activities:** Individuals deriving income from agriculture and forestry if they are VAT taxpayers and those that are VAT taxpayers are deemed to be carrying out independent activities.

**Income from capital:** The tax rate on income from capital is reduced from 20% to 10%. Dividends are taxed at a flat rate of 10% on the gross amount (previously, the tax basis was 80% of the received dividends, and the tax rate was 20%).

**Capital gains:** The capital gains tax rate is reduced from 20% to 10%.

**Personal insurance income:** The tax rate is reduced from 20% to 10%.

**Rates and threshold:** For annual PIT purposes, the uniform nontaxable threshold of three average annual salaries applies to all tax residents, local nationals, foreign nationals and Serbian citizens assigned abroad. PIT is levied, in all cases at progressive tax rates:

- Income up to six times the average annual salary is subject to a 10% tax rate; and
- Income in excess of six times the average annual salary is subject to a 15% rate, i.e. 10% on income up to six times average annual salary and 15% on the excess.

Previously, the nontaxable threshold for foreign nationals resident in Serbia and Serbian citizens assigned abroad was five times average annual salary, while the nontaxable threshold for residents-local nationals was three average annual salaries. The tax rate for foreign nationals resident in Serbia and Serbian citizens assigned abroad was 10% for income up to eight times average annual salary and 15% for income exceeding eight times average annual salary.

**Other changes:** The deadline for declaring foreign-source income, making a self-assessment and paying tax is now 30 days (instead of 15) from the day the income is received.

### Treaty with Austria

The Serbian Parliament ratified the 7 May 2010 tax treaty and protocol signed by Serbia and Austria on 28 July 2010. The treaty and protocol will become applicable as from 1 January of the year immediately following the year in which both countries inform each other by diplomatic means that their respective ratification procedures have been completed. The earliest possible date for the treaty's entry into force is 1 January 2011. The treaty is generally based on the OECD Model Treaty, although there are some deviations from the model. Below is an overview of the most important provisions.

**Dividends:** Dividends will be subject to withholding tax at a general rate of 15% in the source country. A 5% rate will apply where the beneficial owner of the dividends is a company (excluding a partnership) that holds directly at least 25% of the capital of the company paying the dividends.

**Interest:** Source state taxation of interest will be limited to 10%, with an exemption applying where the interest is paid to the central or local government of the other state, the central bank or financial institutions controlled or predominantly owned by the state at any level. The Protocol contains a most favoured nation clause, under which Serbia will be obligated to start negotiations with Austria to revise the 10% tax rate if Serbia concludes a treaty with another EU member state that provides for a lower rate of withholding tax on interest.

**Royalties:** The taxation of royalties in the source state will be limited to 5% rate for royalties paid in connection with the use of literary, artistic and scientific works, including cinematographic films, television films and tapes, and radio tapes. A 10% rate will apply to royalties paid in connection with the use of patents, trademarks, designs, models, plans, secret formulas or processes, as well as for the use (including lease) of industrial, commercial or scientific equipment.

**Capital gains:** While the taxation of capital gains generally corresponds to the OECD Model Treaty, article 13 deviates from the model regarding gains from the alienation of business assets owned by a permanent establishment in that it also includes gains from the alienation of moveable assets used by a fixed base for the provision of independent professional services. Gains from the alienation of other property (other than immovable property situated in the other Contracting State, vessels, boats and aircraft), including shares in companies, may be taxed only by the state in which the seller is resident. An exception to this rule will apply to shares or comparable interests held by residents of the Contracting State in companies that derive more than 50% of their value from immovable property situated in the other Contracting State. Article 13(4) provides that such gains may be taxed in the other state, i.e. the state in which the property is situated.

**Employment income:** Employment income will be taxed in accordance with the OECD Model, but if the employment is exercised by a resident of one Contracting State in the other Contracting State in connection with a construction site, or a construction or an installation project for a period of 12 months during which the site or project does not constitute a permanent establishment in the other Contracting State, the income may be taxed only in the residence state.

**Income of artists and athletes:** Only the residence state will have the right to tax the income of artists and athletes earned for live performances, within the context of cultural or sport exchange programmes approved by both states. The same applies to the legal persons that manage orchestras, theatres and ballet groups, as well as to their members, provided they are non-profit organizations and this is confirmed by the relevant authority in the country where the recipient is resident.

**Pensions:** Pensions will generally be taxed in the country of residence, except for pensions earned on the basis of the social security laws of the other Contracting State, which may be taxed also by that other state.

**Avoidance of double taxation:** Austria generally will eliminate double taxation under the exemption with progression method, except for certain income (dividends, interest, royalties, capital gains from the sale of shares in real estate companies and social security pensions), which may be taxed in Serbia in accordance with the treaty provisions, where Austria will apply the ordinary credit method. Serbia will apply the ordinary credit method with respect to any item of income that may be taxed in Austria under the treaty.

**Exchange of information:** The exchange of information provision corresponds to article 26 of the OECD Model Treaty, and in particular, includes the exchange of banking information. The Protocol sets out certain procedural rules and clarifies that the principles in the Commentaries to article 27 of the Model Treaty will be used to interpret the exchange of information article.

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