

Overview of Major Issues of Tax Treaties Law in Kosovo

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Abstract: The aim of this research is to analyze and find out the major issue of tax treaties law in Kosovo. In this analysis we have used the research method of case study. The results of research show that the legal framework for the elimination of double taxation, after 1999, initially started its establishment journey from the United Nations Administration Mission in Kosovo (UNMIK). Taking into consideration the specifications of the political status, the process for the establishment of the unilateral and bilateral legal framework has been made with mistakes, slow and with delays. Following its declaration of independence, Kosovo has paid greater attention to tax treaties. Although double taxation relief in Kosovo may be obtained either unilaterally or under a tax treaty, there remains a lot of work to be done for the completion of the necessary framework for elimination of double taxation. The double taxation relief provided by a tax treaty prevails over the domestic relief. The study is of particular relevance to scholars, tax practitioners, expatriates who work and invest in Kosovo, etc.

Keywords: tax treaties; unilateral; bilateral; domestic law

JEL Classification: H20

1. Introduction

Every country is free to choose, create, adopt and implement a tax system to comply with its needs and development. However, in spite of different characteristics, tax systems in general are based on several basic principles, that are created with time and improved continuously from the development in the hundred year tax theory and practice of the world. The international tax law and the domestic tax laws are constructed on the basis of respect of double taxation elimination principle. In this aspect, there prevails the idea that in order to increase economic efficiency it is necessary to eliminate double taxation.

Therefore, amongst the economic instruments for promoting the attractiveness of a state for investment are international agreements on taxation, which are usually concluded in the form of tax treaties. Avoidance of double taxation is still the main purpose of tax treaties. Looking at their provisions, other purposes appear to

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include the prevention of tax evasion and avoidance (Sasseville, 2002, p. 96). Tax treaties aim to provide certainty to taxpayers as to their potential tax liability in foreign countries. They allocate taxing rights between treaty partners regarding the persons and taxes covered under the treaty. To this end, tax treaties offer a range of tax advantages which countries agree to grant to each other in order to prevent double taxation and eliminate the barrier that double taxation would create to cross-border trade, investment, movement of persons, etc. (Baker, 2013, p. 3)

Although many taxes have been continuously implemented since 1999, Kosovo is still in the initial stages of developing its tax treaties network and there is significant work that needs to be done to fully design its double taxation relief. Up to the moment of this thesis, Kosovo had only eight treaties for double taxation elimination in power.

Double taxation is a significant issue, because of the large number of Kosovars are working in foreign countries, as well as the significant number of foreigners coming to work or invest in Kosovo. The absence of tax treaties gives rise, in particular, to cash flow problems and excessive bureaucracy, and is most acutely experienced by expatriate workers whose time is divided between Kosovo and other countries. Further, without the exchange of information provisions in tax treaties, Kosovo is at a disadvantage in terms of enforcing its domestic laws when an international company is conducting economic activities in Kosovo. (Peci, 2009a, p. 222). Therefore, the aim of this analysis is highlighting some of basic specifics which characterize major issues of tax treaties Law in Kosovo, with particular emphasis on Kosovo tax treaties and relationship between tax treaties with domestic law.

In this analysis we have used the research method of case study. The research is based on analyzing Kosovo tax treaty relief for avoidance of double taxation and domestic tax law through different papers which talked about international tax law, whereas as the main source of data for analyses we used IBFD publications.

Apart from introduction, paper is laid out as follows: Part II analyses development of Kosovo tax system. Part III analyses tax treaty relief in Kosovo. Part IV presents the overview on relationship between tax treaties and domestic law. At the end conclusions are given.

2. Development of Kosovo Tax System after 1999 War

In the long historical context, the policy and tax systems of Kosovo were followed during their evolution by many changes that were made based on the challenges of the political and socio-economic structure of Kosovo (initially as part of a federal system and later following the deployment of the United Nations Interim Administration Mission in Kosovo (the UNMIK). The first phase covered a long

time period, including the years from 1945 until the dissolution of the former Yugoslavia in the 1990s. The second phase included the period from the 1990s up to the deployment of the UNMIK in 1999. The third phase runs from 1999 until the Kosovo declaration of independence on 17 February 2008. The fourth phase runs from 2008 onwards the future time perspective.

Kosovo, in distinction to other Balkan countries, made the economic transition, including tax reforms, under the influence of quite specific political factors and circumstances (Peci, 2009b, p.46). Reformation of taxation systems constituted only one of the main components of the reforming process within the social-economic transition. The transition process, which in early '90s encompassed many countries of South-eastern Europe, found Kosovo initially in a situation of an undeclared war, which broke out in 1998 and ended by the Kumanovo Agreement (Military Technical Agreement) on 10 June 1999 (Peci, 2009c, p.285). On 10 June 1999, the UN Security Council approved Resolution 1244, by which United Nations Administration Mission in Kosovo (UNMIK) was created and therewith the sovereignty of the SFRY over Kosovo was abolished. Until final status settlement (2008), resolution 1244 vested UNMIK with legislative, judicial and executive powers. Upon UNMIK installation in Kosovo, the Central Fiscal Authority in cooperation with World Bank, the European Commission and the International Monetary Fund, started the work in formulation of measures and strategy for creating an efficient tax system in the spirit of the overall economic and social development of Kosovo. The creation of the policy and tax system in Kosovo by UNMIK is a *sui generis* case, as it was created in practice without any internal influence and without a political dialogue of Kosovo actors (Peci, 2013, p. 71).

The highest authority of the fiscal power in Kosovo from 1999 to the Declaration of independence of Kosovo, on 17.02.2008, was the Special representative of the Secretary General (SRSG) of the UN together with the Fiscal Economic Council as an advisory body to the SRSG for fiscal policy issue.

After proclamation of independence, the fiscal sovereignty moves from UNMIK to the Kosovo Institutions, respectively in the Parliament of Kosovo, as the greatest taxing power in applying taxes through tax laws. In this way, Kosovo institutions inherited a policy and tax system designed from UNMIK, which mainly had fiscal functions. This, due to the fact that the main objective of policy and tax system was gathering funds for financing foreseen public costs, by not giving importance to the economic and social functions which can be achieved through policy and tax system. So, policy and tax system inherited by UNMIK had a very limited function vis-à-vis socio-economic needs of Kosovo and trends of taxing competition in Balkan countries. In such a situation, designers of tax policy of independent Kosovo were forced to consider the reformation of system and tax policy. In December 2008, the Government of the Republic of Kosovo took the first steps in

changing the tax system inherited from the UNMIK. The measures that were taken are only related to reducing the tax rates on the main taxes, with the objective of stimulating foreign investment and allowing taxpayers to pay less tax so as to minimize evasion (Peci, 2010, p.46). In this context, since 1st January 2009 changed only tax rates of main existing taxes, respectively has reduced tax rate of Corporate Income Tax (CIT) from 20% to 10 %, has reduced tax rate of Personal Income Tax (PIT) from 0%, 5%, 10% and 20% to 0%, 4%, 8% and 10%, which means that the highest rate of this tax will be 10% for taxpayers' and business activities. In contrast to above mentioned taxes, tax rate of VAT was increased from 15% to 16%. The Kosovo tax system includes corporate income tax, personal income tax, withholding tax real estate tax, VAT, excise tax, and customs duties (Peci, 2009a, p. 222).

Following its declaration of independence, Kosovo has paid greater attention to tax treaties. In this regard the Office for Legal Issues, Treaties and Human Rights was established within the Ministry of External Affairs in 2008. This office deals with treaty issues regarding the elimination of double taxation.

3. Tax Treaty Relief in Kosovo

The state in various methods may apply measures in order to eliminate double taxation. Depending on the fact whether there are undertake these measures as one-sided legal actions by a country or as cooperation between two or more states, these measures may be classified as: unilateral and international measures (bilateral and multilateral). Unilateral relief expresses granting of relief from the effects of international double taxation on the basis of domestic legislation rather than the provisions of a tax treaty (IBFD International Tax Glossary, 2009, p. 462). Relief typically takes the form of an exemption or credit or in some cases simply a deduction of foreign taxes. Bilateral relief express granting of relief from the effects of international double taxation on the basis of provisions of an international treaty or similar instrument (e.g. within EU, by way of the Parent-Subsidiary Directive). Model treaties are usually bilateral but some multilateral models exist. Multilateral tax treaties are concluded between more than two treaty partners. Examples include the Arab tax treaty, the CMEA tax treaties, and the Nordic Convention. Nations worldwide have adopted the text of Art. 2 ("Taxes covered") of the OECD Model Double Taxation Conventions in concluding bilateral treaties to prevent international double taxation in the area of taxes on income and capital, and taxes on estates, inheritances and gifts (Brandstetter²⁰¹⁰, p.¹). Bilateral tax treaties were originally developed to prevent double taxation of income, primarily double taxation arising from the combination of residence and source taxation. The measures undertaken by Kosovo to eliminate double taxation are unilateral and international. Kosovo, as the newest country internationally

recognized by 106 countries, is in the process of creating the framework for elimination of double taxation. The legal framework for the elimination of double taxation has started by the UNMIK. Taking into consideration the specific political status of Kosovo until the declaration of independence, the process for the establishing the unilateral and international legal framework has been deficient, slow and with delays.

3.1. Unilateral Measures

For eight and a half years (1999-2008), respectively for the duration of the interim administration, there prevailed unilateral measures for elimination of double taxation.

Unilateral measures to eliminate double taxation are based on domestic laws that follow the principles contained in the OECD Model Tax Convention (OECD Model). Because the Kosovo does not have an established comprehensive tax treaty network, the ordinary credit method is applied in order to eliminate from double taxation. Thus, in the absence of a tax treaty, unilateral relief is granted in the form of an ordinary tax credit for income taxes paid abroad. The credit is limited to the lower of the foreign tax and that part of the Kosovo tax which is attributable to the income that has been taxed abroad. A non-resident person with a Permanent Establishment in Kosovo can obtain an official document from the Kosovo tax administration certifying the amount of taxes they have paid, which can be used to obtain a credit abroad (Peci, 2010, p.46).

With respect to taxes on income and capital the Kosovo government introduced Art., 40 of Law No. 03/L-071 on Tax Administration and Procedures to provide for relief from double taxation in the absence of a tax treaty. Art. 40(1) provides that: "where the existing taxation laws of Kosovo relative to international taxation do not address taxation of international transactions, they may be supplemented by application of the principles of the OECD Model Tax Convention on Income and Capital, in order to avoid double taxation of such income and capital". Sec. 40(2) further provides that: "Where the existing tax laws relative to the international juridical double taxation of income and capital of persons in the Republic of Kosovo do not address such taxation, the principles of the OECD Model Tax Convention on Income and on Capital shall apply in order to avoid double taxation of such income and capital". Referring to the OECD Model makes the problem easier but does not resolve it (Peci, 2010, p.46). As it says Klaus Vogel as a rule, however, unilateral measures are insufficient to avoid double taxation because they generally do not cover all situations giving rise to double taxation, and they may apply to double taxation situations inconsistently depending on which state's measures are applied (Vogel, 1986, p.10).

3.2. Bilateral Measures

During the UNMIK administration (1999-2008), the Kosovo authorities did not take an official position regarding the tax treaties signed by the former Yugoslavia. Unofficially, however, they did not recognize these tax treaties.

After deceleration of Independence State of Kosovo take an official position regarding the tax treaties signed by the former Yugoslavia. In Art., 9 of the Declaration of Independence, Kosovo accepted the validity of all international agreements that the former Yugoslavia made in the name of Kosovo Art., 9 provides that Kosovo will: “undertake the international obligations of Kosovo, including those concluded on our behalf by the United Nations Interim Administration Mission in Kosovo (UNMIK) and treaty and other obligations of the former Socialist Federal Republic of Yugoslavia to which we are bound as a former constituent part, including the Vienna Conventions on diplomatic and consular relations” (Kosovo Declaration of Independence, 17 February 2008). Further, on 9 April 2008, the Assembly adopted the Constitution of the Republic of Kosovo, which entered into force on 15 June 2008 and, similarly, provides that all international agreements will be respected.

The former Yugoslavia signed tax treaties with 20 countries between 1975 and 1990 as follows: France (1975), Sweden (1981), Denmark (1981), Belgium (1981), the United Kingdom (1982), the Netherlands (1982), Czechoslovakia (1982), Italy (1983), Poland (1983), Norway (1985), Cyprus (1986), Sri Lanka (1986), Finland (1987), Romania (1987), Hungary (1987), Germany (1988), Egypt (1988), China (1989), the Philippines (1990) and Malaysia (1990). Given the significant socio-economic changes that have occurred since these treaties were signed, as well as changes in tax legislation, the existing treaties clearly need to be revised or renegotiated (Peci, 2010, p.45). During the UNMIK administration, Kosovo has entered into a tax treaty with Albania, which is effective from 1 January 2006. No other tax treaties have been concluded by the UNMIK administration.

Following its declaration of independence in 2008, Kosovo has paid greater attention to tax treaties. In this regard the Office for Legal Issues, Treaties and Human Rights was established within the Ministry of External Affairs in 2008. This office deals with treaty issues regarding the elimination of double taxation. After declaration of independence, Kosovo and several European countries have enacted several agreements signed by the former Yugoslavia. The president of Kosovo has signed the respective decrees for the approval of these agreements, including double taxation treaties. Thus far, Kosovo has ratified five such tax treaties, those with Belgium, United Kingdom, Germany, the Netherlands and Finland. The treaties signed by the former Federal Republic of Yugoslavia are, however, not recognized as applicable by Kosovo (Kosovo Declaration of Independence, 17 February 2008).

Tax agreement signed by Kosovo are based on a project type approved by the Government, which is drafted based on the international basic models drafted for this purpose by the United Nations Organization, UNO (United Nations Model Double Taxation Convention between Developed and Developing Countries, New York: United Nations, 2011) and by the Organization for Economic Cooperation and Development, OECD (Model Tax Convention on Income and on Capital, Paris, OECD, 2010).

4. Relationship between Tax Treaties and Domestic Law

Tax treaties are “dual” in nature in that they are agreements under international law but also form part of the internal laws of the contracting nations (Brandstetter, 2010, p.1). Whereas, with regard to the relation of treaties for the elimination of double taxation with domestic tax laws of countries, in general, the international treaties shall prevail in application. However, it is possible to come across situations when the legislative authority of a contracting state overrides the provision of the international treaty. There are two facts essential in understanding the relation between treaties for the elimination of double taxation and provisions of the domestic tax legislation.

First, treaties do not provide taxation rights to the contracting states but only limit their taxation rights. Respectively, the taxation power of the contracting states cannot, based on the provisions of treaties, state that it has the right to tax any certain income only because so it says in a certain provisions of the text of the treaty, whereas at the same time, in the domestic tax legislation of the contracting country, such a form of incomes is not taxed. Thus, the treaties do not create the right on taxation but only limit them. Such a restriction through treaties shall be made to states as the source of incomes (e.g. dividend tax in the source country to a certain level) also countries of residence of the taxpayer (e.g. the tax calculation obligation paid abroad in accordance with the provisions of the treaty) (Finnerty, Merks, Petriccione, Russo, 2007, p.13).

Secondly, the definitions from the agreement may be different from those that are used in the national tax provisions of the contracting countries. E.g. certain incomes of one contracting country can be treated as an income from the author’s right but this does not mean that it will be treated same in the provisions of the treaty. Thus, sometimes, the provisions of the treaty refer to the national tax provisions of the contracting countries and sometimes not (Finnerty, Merks, Petriccione, Russo, 2007, p. 13) Regarding relationship between tax treaties and domestic law in Kosovo exist monist approach. Under monist approach international law and domestic law are part of one system in which international law always prevails over domestic law (Popovic, 1997, p.250). The priority accorded to treaties is constitutional requirement, in which case rules for the

application of a treaty raise issues of constitutional validity.

The relationship between tax treaties and domestic law is generally regulated by the Constitution. Pursuant to the Kosovo Constitution, international agreements made in accordance with the Constitution are an integral part of domestic law (Constitution of the Republic of Kosovo). Ratified international tax treaties are an integral part of the Kosovo legal system and they derogate particular tax rules provided in domestic legislation. In the case of a conflict between domestic legislation and an international agreement, the latter generally prevails. "Ratified international agreements and legally binding norms of international law have superiority over the laws of the Republic of Kosovo" (Art. 19(2) of the Constitution of Kosovo).

In Kosovo the Constitution is the most supreme legal act of the state with which all laws, by-laws, as well as international agreements entered into by Kosovo must be compatible. By-laws and any other secondary legislation must adhere to the laws on which they were based. Except with constitution supremacy of tax treaties vis-à-vis domestic law is expressed and by law. According to Law on International Agreements "If a International Agreement of the Republic of Kosovo which has entered into force establishes norms other than those established by the laws, other legal acts of the Republic of Kosovo which are in force at the moment of conclusion of the International Agreement or which entered into force after the entry into force of the International Agreement, the provisions of the International Agreements of the Republic of Kosovo shall prevail". (Art.15(2) of Law of International Agreements). Double tax treaties shall be ratified upon signature of the President of the Republic of Kosovo (Art. 10(4) of Law on International Agreements). The request for ratification of the treaty is submitted by the Ministry of Foreign Affairs to the President. The treaty ratification decree issued by the President of the Republic of Kosovo refers to the relevant provisions of the Constitution of the Republic of Kosovo based on which the international agreement should be ratified.

5. Conclusion

Kosovo tax system does not have yet an established comprehensive tax treaty network. Kosovo is still in the initial stages of developing its tax treaties network and much remains to be done in regards to relief from double taxation. Kosovo should intensify efforts to establish comprehensive tax treaty network. Kosovo can achieve this through the signing of the bilateral treaties for elimination of double taxation, with priority, with its major trade partners, with which it does not have any treaties yet, in order to facilitate its involvement in the international division of labour and to intensify its economic and financial relations in the global economic environment.

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