

Tax Alert

Ernst & Young Albania



Double Taxation Treaty between Germany and Albania enters into force

The double taxation treaty between Germany and Albania has entered into force for taxation periods and withholding taxes levied on income generated and paid from 1st of January 2012 onwards.

The Contracting Parties have attached to the tax treaty a protocol, forming an integral part thereof and containing clarifications on specific articles.

The new tax treaty follows in general the OECD Model Tax Convention (OECD MTC). Below are discussed its main tax allocation rules and any related deviations from the OECD MTC. Items not discussed below follow the OECD MTC pattern.

Permanent establishment definition

The new treaty contains the permanent establishment definition of the OECD MTC. However, a construction site, installation project or supervisory activity in connection therewith constitutes, in accordance with the new treaty, a permanent establishment if it lasts longer than 9 months and not 12 months, as proposed by the OECD MTC.

Pursuant to the Albanian domestic tax law, any construction site or installation project constitutes a permanent establishment, leading to local tax obligations, regardless of duration. Also technical services provided to Albanian entities trigger withholding taxation. The new treaty supersedes such domestic rules and provides protection from income taxation in Albania of German enterprises, carrying out constructions, installations or supervisory activities in Albania which last no more than 9 months. Similarly, contrary to Albanian domestic tax law, the maintenance of a stock of goods in Albania solely for the purpose of delivery will not any more constitute a permanent establishment if such goods belong to a German enterprise and no core business activity is conducted in Albania.

Business profits

The tax treaty allows business profits of an enterprise of one Contracting State to be taxed in the other in as much as they are attributable to the activities of a local permanent establishment which is for this purpose considered as a distinct and separate enterprise. In addition, the protocol clarifies that in determining the profits allocable to the permanent establishment, no force of attraction rule will apply and that there can be taxed only profits which are attributable to the actual activity of the permanent establishment for the respective sale, or business or for the part of the contract which is effectively carried out by the permanent establishment.

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Transfer pricing adjustments

Art.9 of the new treaty, which is aligned with the respective article of the OECD MTC, narrows down the scope of application of the related parties definition of the Albanian tax procedures law. Hence income adjustments for transfer pricing reasons require, among others, when the relevant transaction was concluded with a German entity, that the one transacting entity participates directly or indirectly in the management control or capital of the other, or that the same persons participate directly or indirectly in the management, control or capital of both entities.

Dividends

The withholding tax rate applied on cross-border dividend payments can not exceed 5%, when the beneficial owner is a company (other than a partnership) of the other Contracting State which holds directly at least 25% of the capital of the company paying the dividends. Under Albanian domestic law the withholding tax otherwise applied is 10%.

Interests

For interest income the maximum allowed withholding tax rate becomes 5% if the beneficial owner is resident of the other Contracting State. Hence for beneficial owners who are resident in Germany the withholding tax rate of interest payments from Albania is reduced from 10% to 5%. Withholding tax exempt is interest from loans guaranteed or provided by specifically named state agencies of the two countries.

In alignment with the OECD MTC, interest amounts charged in addition to what would have been charged had the parties been unrelated, are not protected by the tax treaty.

Furthermore, pursuant to the protocol, income received from profit participating loans or profit shares or from silent partnerships can be taxed without restrictions in the Contracting State it was derived if same amount was treated as tax deductible while determining the taxable profit of the debtor of the income.

Royalties

The treaty stipulates that the withholding tax rate on royalties paid to beneficial owners who are resident of the other Contracting State may not exceed 5%, hence reducing the 10% withholding tax rate currently applied in Albania. The treaty protection for royalties applies as long as the royalty, when charged to a related party, is in line with the arm's length standard.

Moreover the protocol clarifies that the payments for technical services, including studies or surveys, including blue prints related thereto, for consultancy or supervisory services shall not be considered as royalties but as business profits or income from independent personal services, as the case may be. Thus no withholding tax and no other form of income taxation is allowed in the source country as long as the local activity of the income beneficiary has not led to the creation of a permanent establishment or does not provide grounds for taxation in accordance with Art.14 of the treaty, namely, as income from independent professional services. Accordingly, the Albanian withholding tax of 10%, which is imposed also to technical and consulting cross-border fee payments, is eliminated through application of the new treaty and its protocol.

Capital gains

Capital gains and taxation rights are allocated in accordance with the OECD MTC. In addition, the tax treaty stipulates that when an individual who had been resident of a Contracting State for 5 or more years becomes resident of the other Contracting State, the former State is allowed to tax, under its domestic law, the capital appreciation of shares which such individual holds in a company resident of that State and which appreciation corresponds to the period of his residence at that State. Conversely the new residence country will not tax the same amount. Currently, Albania does not make use of such taxation right. However, if the shares are sold to a local person,

capital gain taxation is triggered in Albania, regardless of country of residence of the transferor. In such a case tax treaty protection for German residents will apply if the shares sold are not effectively connected with a local permanent establishment of the seller and to the extent he had not been previously resident in Albania for 5 or more years or the capital gain realized exceeds the capital appreciation of the shares corresponding to the years of residence in Albania.

Procedure for tax treaty relief from withholding tax

The tax treaty allows the application of withholding tax refund procedures according to which the Contracting State first imposes withholding tax at source in an amount determined in accordance with its domestic law and then requires the taxpayer to file an application for the refund.

Moreover the treaty determines that refund applications must be submitted by the end of the fourth year following the calendar year in which the withholding tax was applied. However, it is also stated that the competent authorities, by mutual agreement, shall implement the provisions for the procedural rules for taxation at source, including direct applications of tax treaty benefits in relation to items taxed at source.

To be noted that under Albanian administrative instructions refund claims should be submitted within 2 years.

Income from independent professional services

Two alternative conditions are introduced by the treaty in order for professional income to be taxable in the source country, namely:

- ▶ The existence of a local fixed base of the income beneficiary
- ▶ Or his stay in that country for periods totaling 183 in any 12 month period and in respect of income only derived from such local activity

Income from employment

Residents of a Contracting State can be taxed in the other, in respect of an employment exercised therein, only if either one of the following three conditions is met:

- ▶ The employment income recipient is present in the other State for more than 183 days in any 12 month period;
- ▶ or the remuneration is paid by or on behalf of an employer who is resident of the other State;
- ▶ or the remuneration is borne by a permanent establishment or fixed base which the employer has on the other State.

Finally the protocol clarifies that remuneration for employment within the framework of hiring out of labor can always be taxed in the source country.

Avoidance of double taxation

For German residents double taxation will be avoided in Germany by means of the exemption method and for the income items explicitly listed in the relevant treaty article, by means of the credit method. On the other hand, Albania will apply for its own residents the credit method, for all items of income which are taxable in Germany.

Other provisions

In line with the OECD MTC, the new treaty contains also provisions for the allocation of taxation rights over other categories of income, of capital, a non discrimination clause, for a mutual agreement procedure between the competent authorities of the two Contracting States for the avoidance of double taxation situations caused by different positions taken, for the exchange of information and for the assistance in the collection of taxes.

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