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Tax Alert

Ernst & Young Albania

Double Tax Treaty between Albania and Spain enters into force

The treaty between Albania and Spain on the avoidance of double taxation entered into force on 4 May 2011. In general, the new tax treaty follows the OECD Model Tax Convention. The definition of the permanent establishment is fully aligned with the one of the OECD Model. Also, the allocation of taxation rights between country of residence and country of source of the income reflects, to a large extent, the Model. Credit method is provided for the elimination of double taxation by the tax residence country in case of both Spain and Albania.

As regards income items which, under Albanian Income Tax Law, attract, upon payment to a non-resident, a 10% withholding tax, the treatment becomes from now on more favorable when such items are paid to a Spanish resident. For the relevant relief to be provided (i.e. the local entity paying the income not to withhold tax or to apply reduced withholding tax rate, depending on the treatment of the relevant income by the tax treaty) approval should be obtained from the Albanian General Tax Directorate.

In particular, the following income items sourced by Spanish residents from Albania are treated more favorably after enactment of the tax treaty:

Payments for consulting, technical, management, financial and insurance services

Income stemming from consulting, technical, management, financial or insurance activities carried out by non-residents not having a permanent establishment in Albania is subject, upon payment by an Albanian entity, to 10% withholding tax. However, under the new tax treaty such income items derived by Spanish residents are subject to tax only in Spain.

Dividends

Dividend payments made by Albanian companies to non-resident shareholders attract 10% withholding tax. However, by virtue of the new tax treaty, withholding tax on dividends paid to a beneficial owner who is resident of Spain shall not exceed:

- ▶ 0% of the gross amount of dividends if the beneficial owner is a corporation (other than partnership) that holds directly at least 75% of the equity of the company paying the dividends.
- ▶ 5% of the gross amount of dividends if the beneficial owner is a corporation (other than partnership) that holds directly at least 10% of the equity of the company paying the dividends.
- ▶ 10% of the gross amount of dividends in all other cases. In addition, the withholding tax treaty relief does not apply to dividends paid in respect of shareholdings effectively connected with a permanent establishment of the recipient in Albania.

Interest

Interest payments made by resident borrowers to non resident lenders attract 10% withholding tax. However, according to the new tax treaty, the withholding tax may not exceed 6% if the beneficial owner of the interest is a resident of Spain. Furthermore, the withholding tax shall be 0% if the beneficial owner of the interest is:

- ▶ The state or central bank, a political subdivision or a local authority of Spain or the loan is owed to or guaranteed by the state, local authority or export financing agency.
- ▶ A tax exempt pension fund of Spain.
- ▶ A Spanish financial institution.

Also the withholding tax rate shall be 0% if:

- ▶ The interest payer is the Albanian state or a local authority thereof
- Or
- ▶ Interest relates to commercial sales on credit.

The withholding tax relief of the tax treaty does not apply if the beneficial owner of the income carries any business activities through a permanent establishment in Albania, to which the interest income is effectively connected.

Also the withholding tax relief does not apply to the extent the interest amount exceeds the one which would have been agreed upon by unrelated parties.

Royalties

Royalty payments made to non-residents are subject to 10% withholding tax in Albania. Under the new treaty, royalty payments to Spanish residents become tax exempt. The withholding tax relief will not apply if the beneficial owner of the royalties carries any business activities through a permanent establishment in Albania, to which the income from royalties is effectively connected.

Also, the withholding tax relief will not apply to the extent the royalty amount exceeds the one which would have been agreed upon by unrelated parties.

Capital gains

Capital gain payments made by residents to non residents are subject to 10% withholding tax in Albania. According to the new treaty the following capital gains derived by a resident of Spain can be taxed in Albania:

- ▶ Gains derived from immovable property situated in Albania
- ▶ Gains derived from movable property forming part of the business property of a permanent establishment situated in Albania including gains from the alienation of such a permanent establishment
- ▶ Gains derived from the alienation of shares or comparable interests deriving more than 50% of their value directly or indirectly from immovable property situated in Albania
- ▶ Gains from the alienation of shares or other rights, which directly or indirectly entitle the owner of such shares or rights to the enjoyment of immovable property situated in Albania

Gains derived by residents of Spain from the alienation of any other property situated in Albania can be taxed only in Spain.

Treaty shopping

According to the protocol signed between Albania and Spain, and forming an integral part of the tax treaty, the withholding tax treaty relief provided for dividends, interest and royalties will not apply in case where the shareholding, lending or royalty right structure is aimed at getting access to the tax treaty benefits.

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