Double Tax Agreements and Kosovo

April 2022

About Policy Spotlight

Policy Spotlight is a publication of the American Chamber of Commerce in Kosovo (AmCham Kosovo) which aims to bring attention on different economic policies and outline the challenges for the development of such policies, in order to pave the way for addressing them. This edition places the spotlight on Double Tax Agreements and Kosovo.
Introduction

Cross-border activities and transactions may trigger tax consequences under the domestic tax laws of different countries. This happens because the sovereignty of the states involved allows them the right to impose taxes. Thus, this creates a risk for double taxation.

Nowadays, countries are always striving to include the elimination of double taxation when designing their tax policies, therefore this results in applying Double Tax Agreements which help in achieving this goal.

This policy provides general information on International Double Taxation and Double Tax Agreements (DTAs) as a way for eliminating it.

Special emphasis is given to the treatment of this issue in the state of Kosovo.

International Double Taxation - Overview

International double taxation occurs when public authorities of different countries impose the same tax, for the same taxpayer, at the same period of time.

Cross-border activities and transactions may trigger tax consequences under the domestic tax laws of different countries. This happens because the sovereignty of the states involved allows them the right to impose taxes. Thus, this creates a risk that two countries may have the right to tax the same item in the hands of the same person.

The double taxation may be economic or juridical. Economic double taxation arises in international taxation when the same economic transaction, item or income is taxed in two or more States during the same period, but in the hands of different taxpayers. In juridical double taxation, two or more States levy their respective taxes on the same entity or person on the same income and for identical periods. (Rohatgi 2005)

When it comes to international double taxation, these two principles are of particular importance:

1. **Worldwide principle of taxation:**

   This principle occurs when foreign-earned income is included in the domestic tax base. So, a country applying a worldwide principle subjects its residents to tax on their worldwide income whether derived from sources in or outside its territory (OECD, oecd-ilibrary.org 2014).

2. **Territoriality principle of taxation:**

   This principle occurs when non-residents are taxed according to the source of income, which means that the taxpayer, whether a natural or legal person, must pay the tax to the state in whose territory the income was generated (Peci 2017). Countries that apply this principle, exclude foreign income and tax only domestic income.
These two principles, when combined, are the main cause leading up to international double taxation, but it can also occur when there is compliance of a same principle by both states involved.

**Double Tax Agreements**

Double Tax Agreements, also called Tax Treaties or Conventions, are agreements between sovereign nations, which are drawn up to mitigate/eliminate double taxation (by determining the extent to which each state may levy tax), prevent fiscal evasion, and foster cooperation between signatory states.

DTAs relate to capital and income tax and create legal basis for all individuals or companies which are a tax subject in the two countries negotiating the agreement.

These treaties are considered to have a dual nature: on one hand, they are agreements between the governments of the two states for the allocation of fiscal jurisdiction, and on the other hand they become part of the tax law of each state (which is a party to it), either by their incorporation into domestic legislation, or by their application as a bilateral agreement ratified by the state. (Peci 2017)

DTAs are nominally reciprocal. If capital flows are equal between the countries, by applying DTAs, countries would also apply justice; what a country loses on the source side is made up on the residence side. If capital flows are less even, the revenue consequences may be substantial. (UN n.d.)

**Objectives of DTAs**

Originally, the focus of tax treaties was almost exclusively on solving the problem of double taxation (UN n.d.). But now there are also other important objectives of DTAs which are: the prevention of tax evasion and avoidance or double non-taxation; the elimination of discrimination against foreign national and non-residents; facilitating administrative cooperation between the contracting states (which includes: exchange of information, assistance in the collection of taxes and dispute resolution); providing legal certainty for taxpayers; promotion of mutual economic relations, trade and investment etc.

**Model Conventions**

DTAs are usually based on the following model conventions:

2. United Nations Model Double Taxation Convention between Developed and Developing Countries. (Nations 2017)

The use of the text of these model conventions is at the discretion of the states, which are free to decide whether they want to include the entire or only part of the text of the model convention in...
their agreement. Thus, the text of the model conventions is only a recommended format for use, the implementation of which is not mandatory.

The interpretation of treaties, including tax treaties, is governed by the rules of the Vienna Convention on the Law of Treaties.

**DTAs and Kosovo**

The relationship between treaties (tax treaties) and the domestic law of Kosovo is regulated by the Constitution of the Republic of Kosovo and also by the Law on International Agreements.

Article 19 of the Constitution states: (Kosovo 2008)

1. International agreements ratified by the Republic of Kosovo become part of the international legal system after their publication in the Official Gazette of the Republic of Kosovo. They are directly applied except for cases when they are not self-applicable and the application requires the promulgation of a law.
2. Ratified international agreements and legally binding norms of international law have superiority over the laws of the Republic of Kosovo

And, article 15 (paragraph 2) of the Law on International Agreements states:

“If an 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.” (Kosovo, Law on International Agreements n.d.)

The Tax Administration of Kosovo is responsible for implementing the provisions of the Double Tax Agreements. It provides services to taxpayers who are covered by DTA between Kosovo and any other country and also sets out the procedures for implementing these agreements. (ATK n.d.)

Kosovo is a party to 21 Double Tax Agreements, three of which date back to the former Yugoslavia and two of which are not yet applicable.

Most of these agreements have been negotiated with the respective states, while the agreements signed by the Former Socialist Federal Republic of Yugoslavia have been inherited from Kosovo and their application has continued in the state of Kosovo. (Abdullahu 2019)

_Below you will find a table prepared from the data provided by the website of the tax administration of Kosovo on DTAs between Kosovo and other countries._
<table>
<thead>
<tr>
<th>Country</th>
<th>In force from Kosovo</th>
<th>Applicable</th>
<th>Comments</th>
<th>Dividends</th>
<th>Interest</th>
<th>Royalties</th>
</tr>
</thead>
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<td>10%</td>
<td>0%</td>
</tr>
<tr>
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<td>13.04.2012</td>
<td>From former Yugoslavia</td>
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<td>15%</td>
<td>10%</td>
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<td>01.01.2016</td>
<td>01.01.2016, January 2011</td>
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<td>10%</td>
<td>10%</td>
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<td>01.01.2017</td>
<td></td>
<td>5%</td>
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<tr>
<td>The Grand Duchy of Luxembourg</td>
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</tr>
<tr>
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<td>02.09.2011</td>
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<td>01.01.2015</td>
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<td>0%</td>
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<td></td>
<td></td>
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<tr>
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<td>Kingdom of Saudi Arabia</td>
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<tr>
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<td>01.01.2016</td>
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<td>Switzerland</td>
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<td>01.01.2019</td>
<td></td>
<td>5/10%</td>
<td>5%</td>
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</tr>
</tbody>
</table>
The impact of DTAs in Kosovo

Although DTAs are designed on the basis of the non-discrimination principle, their impact on developing countries like Kosovo, in practice, does not indicate this.

Example:

**DTA agreement between Kosovo and Switzerland**

A Kosovar citizen who generates income in the state of Switzerland, for his income he will be taxed by the state of Switzerland (the source country of his income) and vice versa.

*De jure,* this agreement provides non-discrimination and equal treatment. But *de facto,* these two countries are unequal from the beginning, because *from a developmental point of view,* they are completely opposite to each other.

This is explained by the fact that the number of Kosovar citizens who generate income in Switzerland is very large, while the same does not happen with the number of Swiss citizens who generate income in Kosovo.

Thus, more developed countries like Switzerland, benefit more from these agreements because they attract more employers and gain revenue from their taxes, while Swiss citizens have no interest in working and generating income in Kosovo, since Kosovo does not have a developed economy and this results in a not favorable work environment as well.

The example expresses the disadvantage of implementing DTA’s in Kosovo, but on the other hand, if Kosovo focuses on creating a good business climate and manages to keep low tax rates, these agreements would be so beneficial due to the fact that they would contribute on attracting foreign investors, which would result in high profits for the country.
Conclusions and Recommendations

Conclusions:

International Double Taxation is a serious concern that states are facing nowadays, which are constantly tending to solve this problem through Double Tax Agreements (also called Tax Treaties or Conventions).

These agreements, except their objective for eliminating double taxation, also aim to avoid tax evasion or non-taxation, positively impact on cooperation between the contracting states, promote mutual economic relations, trade, investment, etc.

One of the basic principles of DTAs is the non-discrimination principle, which is always included in the agreements, but de facto is not applicable for developing countries such as Kosovo. Thus, the parties agree on mutual rights, but since Kosovo (in this case) as a developing country, in principle is not equal to a developed country, the points included in the agreement may be discriminatory to it.

AmCham’s recommendations:

Despite these challenges, if Kosovo manages to be careful not to raise tax rates and at the same time to apply these double tax agreements, DTAs would greatly contribute to our country and would be very necessary in order to attract foreign investors. The benefits that would come from foreign investors would offset Kosovo’s challenges as a country with an underdeveloped economy, hence, the implementation of DTA would be highly profitable and effective.
References


