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Taxation of cross-border distribution of profits in Albania: Does it approach the scope of the EU Parent-Subsidiary Directive?

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Abstract

Albania’s journey towards EU membership is governed by the Stabilization and Association Agreement (SAA), signed on June 12th, 2006. This article rises above Albania’s obligations for the alignment of its tax legislation with EU standards and acquis, clearly defined in Title VI of the SAA. Unlike any prior analysis of legal and political character published, it aims to analyze the extent to which the Albanian tax legislation complies with one of the most important legislative acts of the EU law, the Parent-Subsidiary Directive, which aims to eliminate double taxation in the distribution of cross-border dividends. Three main conclusions have been drawn: First, Albania seeks to eliminate double taxation arising from cross-border distribution of profits mainly through double tax treaties. Second, in case of inbound dividends, as the State of Residence of the parent company, unless the State of source has a double tax treaty with Albania, Albania’s tax legislation does not exempt or gives a credit for the foreign income tax already levied on the distributed profits. If the State of source has a DTT signed with Albania, Albania tax system follows an asymmetric approach, applying simultaneously the exemption method for the domestic intercompany dividends, but it provides no more than indirect credit for inbound cross-border intercompany dividends. Third, also for outbound dividends, as the State of source, Albania levies a withholding tax only for dividends and distributions of profits paid to non-residents, while it reduces or exempts the withholding tax only if Albania has signed a DTT with the other State. Although, cross-border double taxation is taken into account by Albanian tax legislation, seen in the context of the approximation of Albanian legislation with the EU law on direct taxation, Albania does not comply sufficiently with the objective scope of the Parent-Subsidiary Directive yet. Therefore, future changes in Albania direct tax legislation would line it up with EU objective on the free movement of capital and goods and the removal of obstacles for the internal market.

Keywords: EU Parent-Subsidiary Directive, Dividends, Albania direct taxation, Double taxation, Acquis communautaire

JEL Classification: K34; F23; F53; H25; H77; H73

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I. ALBANIA TOWARDS EU: DUTIES AND GOALS IN THE AREA OF TAXATION

1.1 Role of SAA with Albania for the alignment with Acquis Communautaire

After three years of negotiations Albania signed the Stabilization and Association Agreement and Temporary Agreement on Trade and Commercial Cooperation on June 12th, 2006 in Luxembourg, at the Council of General and Foreign Issues. The Stabilization and Association Agreement (SAA) falls under the mixed agreement or associate agreement where the Union may conclude with one or more third countries or international organization agreements establishing an association involving reciprocal rights and obligations, common action and special procedure and represent the legal base between the candidate countries and the EU and the Member States in ex parte. The SAA aims to provide the formal mechanism and the agreed benchmarks, that allow the EU to work with each country to bring them closer to the standards which apply in the EU\(^2\). In order to be part of the Agreement, Albania needed to comply with the criteria determined by the European Council of Copenhagen in June 1993\(^3\). Approximation of domestic legislation with the EU acquis is one of the conditions for the accession of candidate states to the EU, confirmed by the European Council at the Copenhagen Summit in 1993. The accession criteria or Copenhagen Criteria are the essential economic and political conditions all candidate countries must satisfy to become a member state of European Union\(^4\). A candidate country, in order to become a Member State should have already achieved the stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities, as well as a functioning market economy, administrative and institutional capacity to effectively implement the acquis and ability to take on the obligations of membership\(^5\). In case of Albania, same as for other Southeast European countries, its journey towards EU membership has to be governed by the

\(^5\) An effect of the Copenhagen criteria, especially of the political criterion, is the introduction in the EU Amsterdam Treaty in its Article 49, which provides that the Union is founded based on principles of freedom, democracy, respect for human rights and state of law. The same criteria are foreseen also in the texts of constitutions of member states. Compatibility with all these criteria is being monitored by the European Commission in its progress-reports for applicant countries or potential applicants to EU.

**Stabilization and Association Agreement (SAA)**. The SAA is intended to establish a close and lasting relationship based on reciprocity and mutual interest, which has allowed Albania to further strengthen and extend the already established relationship with the European Union. The achievement of candidate status for Albania shows its commitment and compliance in respect of its SAA.

Albania’s EU membership process would be the subject of a broad and general analysis given the interconnection of many political phases and conditions starting with the signature of Stabilization and Association Agreement, the obtention of candidacy status and then the progress and finalization of integration process. Therefore, it remains out of the scope of this article. Although, for comprehensive reasons, it is of crucial necessity, to mention that the rights and obligations that arise from SAA with Albania are independent from the accession process and bind the signatories regardless of the success of the path to EU membership. The EU-Albania SAA is extensive and like all other SAAs is based largely on the Europe Agreements. It covers a wide range of areas from political dialogue to regional cooperation, and from freedom in the movement of goods, services, workers and capital to mutual cooperation in justice and home affairs. Importantly, the SAA calls for the establishment of a free trade area between the two parties. Its objective is the integration to the fullest possible extent into the political and economic mainstream of Europe in a view of its status as a potential candidate for EU membership, as well as to support the efforts of Albania to develop its economic and international cooperation through the approximation of its legislation to that of the Community. The SAA is not confined to border controls but covers several policy and regulatory areas for deeper integration. It recognizes that the policy harmonization is a long-term target and places increasing emphasis on its gradual implementation. Therefore, Albania is required to undertake a gradual harmonization of legislation with that of the EU in the areas of standards, certification and accreditation and customs administration. The Albanian

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6 *Stabilization and Association Agreement between the European Communities and their Member States, of the one part, and the Republic of Albania, on the other part was signed in Luxembourg on 12 June 2006 and entered into force on 1 April 2009. Article 1 (1) and Article 1 (2) of SAA submit the aims of this Association.*

7 See *Agreement between the European Community and the Republic of Albania, on trade and commercial and economic cooperation.*


10 See Preamble and Article 1, Paragraph 1 and paragraph 2 of SAA with Albania.

11 Less than a month after the official signing of the SAA on the 12th June 2006, the Albanian government adopted the National Plan for the Implementation of the SAA (NPISAA). The document repealed previous decisions of the Council of Ministers on the Action Plan for the implementation of the European Partnership and on the National Plan for the Approximation of Legislation NPAL (which had enforced the importance of the process of the approximation of Albanian legislation). The NPAL recalled the achievements of the stabilization and association process and outlined the country’s objectives in the field of alignment with EU acquis based on the European Partnership, EC progress Reports, draft text of the SAA including the anticipated requirements of the Interim Agreement. The structure of the NPAL was
government translated the obligation stemming from SAA into the National Plan for the Implementation of the Stabilization and Association Agreement, as last amended in 2017. In this way, through a top-down approach, the EU norms are penetrating in the Albanian legal system by obligating the Albanian government to approximate and ensure its proper implementation.

Albania’s obligations regarding the alignment of its legislation with EU standards and *acquis* are clearly defined in the Title VI (Approximation of Laws, Law Enforcement and Competition Rules) of the SAA. Article 70 of the SAA stipulates that this process will take place in two consecutive phases of the transitional period, starting with the fundamental elements of the internal market and related areas for five years period. The transitional period for approximation as well as a deadline for the adoption of the internal market *acquis* are set to a maximum ten-year period, under the Article 6 of the SAA. Internal market acquis and related areas are covered during the first transition period. On this wise, the approximation of laws consists on the adoption of *acquis* in the Albania’s legal system and the previously mentioned provision is the only one in Albania SAA dealing with subject issues.

The relevance of SAA for the approximation of laws is crucial because it results to be an essential condition for liberalized market access for Albania goods and services to the EC. Furthermore, the implementation of the agreement relates with direct effect in the Albanian national legal system. The direct applicability of the direct obligations with the aim of the alignment with the *Acquis Communautaire* and the approximation of laws that have derived from the SAA with Albania, is expressly mentioned under the Article 122 of the Albanian Constitution. Article 122 (1) underlines the direct implementation of any international agreement once it is published in the Official Journal of the Republic of Albania. The prevalence of the international agreements over the national law is determined in paragraph 2 of the same article according to which "an international agreement that has been ratified by

See also Vurmo, G. (2008). Relation of Albania with the EU.


law has superiority over laws of country that are not compatible with it”16. Article I22 provides for the supremacy of international agreements over domestic law, excluding accordingly the application of the rule of lex posterior. SAA is treated in the context of international agreements ratified by the Republic of Albania. The reasoning for that is based on the argument that for the time being Albania is not an EU member state17.

1.1.1. Albanian Interim Agreement

On one hand, certain provisions of the SAA require action to be taken as of the signing data, while on the other hand, the conclusion of an SAA is simultaneous with the signing of an Interim Agreement intended to implement provisions of the SAA related to trade and trade matters18. It replaced the Trade, Commercial and Economic Co-operation Agreement between Albania and European Community and aims at establishing a free trade area between Albania and the EU within a ten-year period. The development of trade links by strengthening and widening the relations based on reciprocity and mutual interest, highlights the necessity to implement provisions of the Stabilization and Association Agreement on trade and trade-related matters as soon as possible19.

The Interim Agreements being in principle free trade agreements, one might question their relevance for direct taxation. A particular area of direct tax legislation which is affected by the Albanian Interim Agreement is corporate income taxation. Albania, like other Southeast European countries has manifested its desire to attract foreign investments and to create a favorable business climate for investing in Albania, by providing low nominal corporate income tax rates20. Starting from 2008 until 2013 the corporate income tax rate in Albania was almost half of the European average. In addition to generous profit-based corporate tax incentives, Albania has been nurturing an attractive business climate by offering investment incentives in the form of more favorable tax regimes, bilateral double-taxation and

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18 See the Introduction of Albania Interim Agreement (Agreement between the European Community and the Republic of Albania, on trade and commercial and economic cooperation).
19 Despite the low rates, revenues are not particularly low in Albania, same as for other South East economies. High levels of investment and/or a high degree of incorporation by businesses might be one among other causes. For example, low tax rates may act as incentives for business incorporation, allowing entrepreneurs to earn lower-taxed capital instead of higher-taxed labor income. For more, see “Tax Policy in South East Europe”, in OECD (2018), Competitiveness in South East Europe: A Policy Outlook 2018, Competitiveness and Private Sector Development, OECD Publishing, Paris, https://doi.org/10.1787/9789264298576-en.
multilateral trade agreements, cheap and effective labor force. It also makes use of presumptive and preferential tax regimes targeted at small and medium-sized enterprises. Further developing and strengthening trade relations between Albania and EU countries, emphasizes the role of the Albanian Interim Agreement to prohibit 'any State aid which distorts or threatens to distort competition by favoring certain undertakings or certain products, as well as decisions by associations of undertakings which have as their object or effect the prevention, restriction or distortion of competition'. Therefore, the Interim Agreement instructs that the acquis be used for the purposes of assessing whether prohibited state-aid schemes exist. It may impact direct tax measures which infringe the free movement of goods and limit the space for providing tax incentives in comparison to the time before their entry into force, while introducing the acquis as the reference for determining the applicability of such provisions.

1.2 The impact of SAA on Albania tax legislation

As mentioned above, the SAA creates the obligation for the Albanian government to align its existing and future legislation with the EU legislation. Hence, it is considered as a primary impulse to establish trade liberalization and to radically transform Albania’s legal foundations in order to comply with the European standards. Almost all major recent legal interventions are inspired by the SAA, which constitutes a core document on the reciprocal obligations of the EU and Albania. The legal reform in order to approximate the Albanian legislation with the acquis of the EU is closely connected with the position of the SAA in the national legal hierarchy from which derives the basic obligation for the approximation process. Article 70 (1) of SAA stipulates that both parties “recognize the importance of the approximation of Albania's existing legislation to that of the Community and of its effective implementation” and “Albania shall endeavor to ensure that its existing laws and future legislation shall be gradually made compatible with the Community acquis”. Referring to the words ‘approximation’ and ‘shall endeavor’ it can be concluded that the SAA provides a voluntarily

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21 In Albania, businesses with annual turnover below ALL 5 million (Albanian lek, about 37 200) enjoy a 0% CIT rate, while for SMEs with turnover between ALL 5 and 8 million (EUR 37 200-59 400) the rate is 5%. See “Tax Policy in South East Europe”, in OECD (2018), Competitiveness in South East Europe: A Policy Outlook 2018, Competitiveness and Private Sector Development, OECD Publishing, Paris.
22 Four main principles govern the Albanian tax system: (i) Principle of legality, based on which the rules, values and ways of collection of all kind of taxes and duties shall be drafted and assigned by law; (ii) Annual principle, according to which, the parliament must annually give to the government the authorization for the collection of taxes; (iii) Principle of equality, according to which, the tax burden should be proportionate to the taxpayer’s ability to pay and (iv) Principle of convenience, based on which, taxes should be collected in a way and time that is convenient to the taxpayer.
harmonization and does not constitute an obligation for Albania to incorporate the acquis. But in practice the endeavors clause in article 70 (1) of SAA is a precondition for accession as confirmed by the Copenhagen Summit and embodied in article 49 of TEU stating that the conditions of eligibility agreed upon by the European Council shall be considered. Therefore, despite the endeavor’s clause, Albanian progress towards the EU membership depends on the approximation of domestic legislation and its effective implementation.

Prior to the conclusion of the SAA the integration process had no significant impact on direct tax legislation of Albania. It did or did not adopt certain solutions found in EU legislation by virtue of their quality in combating for instance tax avoidance and tax evasion, or in order to become more attractive for international investors. This leads to the confirmation that Albania, as an aspiring country has aligned so far its legislation to EU standards by virtue of the stabilization and association process. Hence, the implementation of the Stabilization and Association Agreement has influenced Albania's direct tax law through the acquis.

As pointed out above, the Stabilization and Association Agreement, "quite similarly to EU primary law, does not expressly deal with direct taxation issues in any notable detail". In the SAA concluded with Albania, the only article exclusively dedicated to taxation is the Article 98, which asks for Albania and European Union to cooperate in the area of taxation, including all the measures aimed at further reforming the fiscal system and the reconstruction of the tax administration in order to guarantee the efficiency in tax collection and to fight the fiscal evasion. Such cooperation shall take due account of priority areas related to the Community acquis in the field of taxation and in the fight against harmful tax competition.

This is the only article of SAA which discloses the aim of the association in supporting the efforts of Albania to develop its economic and international cooperation, through the approximation of its legislation to that of the Community. However, it is in the obligation to endeavor to gradually approximate existing and future legislation of Albania with the Community acquis in respect to the elements of the acquis referred to in the SAA, that the real force for the adoption of the acquis is found.

In the provision of SAA with Albania, those elements of the EU secondary legislation which deal with the material aspects of direct taxation, - the Parent-Subsidiary Directive, the Merger Directive and the Interest and Royalties Directive, - are not considered and indicated as

27 See Article 98 (1) of Stabilization and Association Agreement between the European Communities and their Member States, of the one part, and the Republic of Albania, on the other part [2009] OJ L107/166 (SAA).
priority areas. Therefore, the Albanian stabilization and association process following the signature of SAA with Albania does not entail the introduction of the provisions in Albanian tax legislation.

Also when referring to the Treaty on the Functioning of the European Union, as the primary law governing in the EU, it takes a different approach towards the material aspect of direct taxation compared to indirect taxation\(^\text{29}\). The Treaty of Rome, 1957 left these type of taxes outside of its scope because they were not seen as key measures for establishing and developing the internal market. Additionally, Member States were not willing to give up their competences and decide on direct taxes at the EU level, reasoning that they were convenient instruments driving forward their economy. As a result, direct taxes still remain within the competence of Member States\(^\text{30}\). The only tool left for providing for a legal basis to start the harmonization process is Article 115 of TFEU. TFEU grants the Council the right to enact directives aligning laws and regulations influencing the functioning of the internal market.

The adoption of these directives require unanimity in the Council and in this context, the will of the Member States plays a vital role\(^\text{31}\).

The issue of the approximation of Albanian legislation with the main body of the EU directives dealing with direct taxation will arise during accession. As Albania is a country aspiring to join the EU, the principles of the Albanian tax system are harmonized with the principles of the Code of Conduct for Business Taxation. Although the Code of Conduct does not have binding power in a legal sense, it has a strong political influence. The invocation of the Code of Conduct for Business Taxation does instruct Albania to abide by its principles in designing or amending its tax legislation. It also provides for measures in any legal forms but also a specified test, assessing whether a tax measure is harmful or not\(^\text{32}\). It defines the tax legislation *acquis* and seeks to eliminate tax incentives, which could cause harmful tax competition within the EU\(^\text{33}\). Clearly, on one hand, the Code of Conduct for Business Taxation and perhaps the Mutual Assistance Directive are within the prerogatives of the SAA. On the other hand, the high relevance placed on the capacities of the Albanian tax authorities

\(^{29}\) Regarding to indirect taxation, Article 113 of TFEU provides for the harmonization of legislation concerning turnover taxes, VAT, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.

\(^{30}\) Lukasz Adamczyk and Alicja Majdanska, ‘The sources of EU Law Relevant for Direct Taxation’ in Michael Lang, Pasquale Pistone, Josef Schuch and Claus Staringer (eds), Introduction to European Tax Law on Direct Taxation (Linde 2016).


to combat fiscal evasion, as well as on the obligation to improve transparency and the exchange of information with the EU Member States do not clearly instruct Albania to apply the Mutual Assistance Directive in its tax legislation. Namely, Article 98 of the Albanian SAA explicitly stipulates the requirement for the Parties to recognize the importance of improving transparency and the exchange of information between the Member States of the European Union and Albania in order to facilitate the enforcement of measures that prevent the avoidance or evasion of taxes\textsuperscript{34}. The cooperation between Albania and the Member States of the European Union explicitly required under this article of SAA, also implies a consultation process between the parties in order to eliminate harmful tax competition and to guarantee equality in business taxation\textsuperscript{35}. On this premises, Albania adhered to the Convention on Mutual Administrative Assistance in Tax Matters since 2013. Pursuant to this Convention, the Albanian tax administration has the right to receive information not only from banks and other financial institutions but also from each individual who possesses the information concerned. In March 2016, Albania approved the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information and assigned the Ministry of Finance and the General Tax Directorate as the appointed competent authority for Albania\textsuperscript{36}. Additionally, the Strategic Plan for the European Integration underlines the commitment of Albania on respect of the Code of Conduct on Business Taxation\textsuperscript{37} through the non-imposition of additional harmful taxation practices. Summarizing in a broad descriptive way: the approximation of Albanian with European Union legislation in the area of taxation as a current strategic objective will be achieved through the harmonization of taxation policies with the acquis of EU, through the creation of a favorable climate for the dynamic development of private enterprises and for the attractiveness of foreign investments, through tax policies that support social and economic development in Albania, as well as


See also Article 98 of SAA with Albania.

\textsuperscript{35} Thuronyi, V. (2010). Tax Treaties and developing countries (pp. 441-455) in Lang, M. (2010). Tax treaties: building bridges between law and economics. IBFD.


\textsuperscript{37} On 1 December 1997, the Council and the representatives of the governments of the member states, meeting within the Council, adopted a resolution on a Code of Conduct for business taxation, with the objective to curb harmful tax competition. The Code of Conduct is not a legally binding instrument but is a political commitment by member states to: re-examine, amend or abolish their existing tax measures that constitute harmful tax competition (rollback process); and refrain from introducing new ones in the future (standstill process). Whilst the original focus of the Code of Conduct was on EU member states, member states also committed to promote the adoption of its principles by third countries and in territories to which EU treaties don't apply. See https://www.consilium.europa.eu/en/council-eu/preparatory-bodies/code-conduct-group/
through the improvement of the tax administration based on integrity, professionalism and honesty in such a way to increase the credibility of Albanian citizens, as well as of international partners and of domestic and foreign business community.

*Acquis* in direct taxation relates to certain aspects of profit tax and the avoidance of double taxation. One focus remains the elimination of irregularities in cross-border economic activities within the European Union. As mentioned above, it is the Code of Conduct on Business Taxation that represents a political commitment by Member States to address harmful tax competition. EU legislation in the field of administrative cooperation and mutual assistance between the tax and customs authorities of the Member States provides the means to exchange information in order to prevent tax evasion and avoidance and their assistance in the implementation of customs legislation. Certain tax and customs information is automatically exchanged; other information is exchanged spontaneously or after a request. Unfortunately, the European Commission in its *Albania Report 2019*, when pronouncing on administrative and mutual assistance, makes clear that Albania has not yet established a central liaison office to automatically exchange financial account information based on the OECD single Global Standard. Seen from Albania’s perspective, an internal key factor in the approximation of the Albanian legislation with the *Acquis Communautaire* is the Albania’s National Plan for Integration in European Union, which lays out the main overall strategic objective of Albania in the area of taxation. In accordance with the objective, *acquis* in the area of indirect taxation consists mainly of the harmonization of the legislation regarding the value added tax and the excise, while the *acquis* in the area of direct taxation has to do with certain aspects of taxes on profits and the elimination of double taxation and of irregularities in cross-border economic activities between companies within the Union.

### 1.3 Key moments of Albania process in harmonizing taxation with EU

*The Albania Report 2019* of the European Commission contains nuances of positive evaluation with respect to the moderated progress and preparation of Albania in the area of

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38 “Albania does not yet have the technical capacity to facilitate the efficient exchange of information, nor does it have the appropriate infrastructure to apply EU IT standards. The electronic tax administration system continues to be operational since January 2015, but the IT department strategy must still adopt its plans to achieve interconnection and interoperability with EU system.”


taxation, explicitly mentioning the alignment of Albanian legislation to EU requirements in a number of areas, which enhances its ability to assume the obligations of the membership. The European Commission acknowledges also the strengthening of the Albanian General Directorate of Taxation (GDT) as well as the establishment of the fiscal cadaster for buildings. Following the recommendations for future progressive steps, through which European Commission asks for Albania to simplify its tax system in order to encourage enhanced tax compliance as well as to join the Inclusive Framework of OECD anti-Base Erosion and Profit Shifting Project, on 28 of May 2019, Albania signed the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI). It became the 88th jurisdiction to join the Convention, which now covers almost 1,530 bilateral tax treaties. As committed, in August 2019, Albania became the 133rd nation to join the Inclusive Framework on BEPS. By joining the Inclusive Framework, Albanian authorities have committed to adopt and monitor the implementation of “minimum standards” on multinational group taxation devised by the OECD and G20 countries in 2015 as a result of BEPS Action Plan. Such minimum standards require Albania to collect country-by-country reports on large multinational groups and to exchange those reports with other countries, to abolish tax practices deemed “harmful,” to limit tax incentives for intangibles income in patent boxes, to spontaneously exchange information on advance tax rulings, to ensure that taxpayers have access to the mutual agreement procedure set out in tax treaties for resolving cross-border tax disputes, and to include an anti-abuse clause in tax treaties. Having joined the Inclusive Framework on BEPS, the Code of Conduct Group agreed on September 13, 2019 that Albania should be removed entirely from “The EU list of non-cooperative jurisdictions for tax purposes” (Annex II). According to the announcement of the Council of the European Union Albania has implemented all necessary reforms to comply with EU tax good governance principles. Inspired by international developments, the Albanian tax legislation


42 In November 2017, with Law no.107, the Albanian Parliament changed the methodology on which the payment of the tax on buildings was based, introducing fundamental amendments. The building tax is a local tax which is calculated, administered and collected by the local authorities. The “fiscal cadastre” is the central registry of the real estate database that serves for purposes of administering the immovable property tax.


44 See Albania joins Inclusive Framework on BEPS to address multinational tax issues, in Multinational Group Tax & Transfer Pricing News, October 2019.

45 The EU list of non-cooperative jurisdiction for tax purposes helps EU member states deal more robustly with countries that encourage abusive tax practices. The aim is not to name and shame countries, but to encourage positive change through cooperation.


See also October 2019 note to Council on the update to the EU list of non-cooperative jurisdiction on business taxation.
provides local tax authorities with the right to re-characterise or disregard transactions in case of lack of substantial economic reasons and effects. With the assistance of the International Finance Corporation, an elaborated Transfer Pricing regulation has been drafted in accordance with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (2010). The Transfer Pricing regulation was subsequently extended in 2015 with a detailed instruction on Advance Pricing Agreements. In this context, there is now increased scrutiny over transactions involving ‘tax havens’. Transactions between an Albanian resident person or a non-resident Albania person having a PE in Albania and a person resident in a jurisdiction listed in the transfer pricing regulation, is deemed a ‘controlled transaction’ and is subject to transfer pricing requirements, regardless of the relationship between the parties.

A new Law on VAT is effective as of 1 January 2015, which has been significantly harmonized with the corresponding EU Directive 2006/112/EC and has brought significant changes to the main VAT principles and rules in Albania. A new Customs Code has been conceived and structured in line with the Union Customs Code (UCC), which was adopted as Regulation (EU) no. 952/2013 of the European Parliament and of the Council.


The exercising of the fundamental freedoms to cross-border activities in the EU internal market by business and citizens should never in itself lead to increased taxation in comparison with the taxation of similar taxpayers within their own Member State. The only reason why direct taxation persists nowadays is that there is almost no direct tax harmonization among the tax systems of different states, even within the European Union. Double taxation in a cross-border context as a result of inconsistent interaction of different domestic tax systems, is a major impediment and a real challenge for the internal market. It is argued that the imposition of comparable taxes in two (or more) Member States on the same business activity is a severe obstacle for the free movement requirement of the internal market concept.

49 COM (2011) 712 final, p.3. [Double Taxation in the Single Market].
When a subsidiary company in one State distributes its profits to its parent company in another State, this may give rise to two crucial tax problems. In the first place, the State of establishment of the subsidiary may levy a withholding tax on outbound dividends. Secondly, the State of establishment of the parent company may include the incoming dividend in the taxable income of the parent company, which may lead to international economic double taxation of the profits out of which dividends were paid, once in the hands of the subsidiary and once in the hands of the parent.

Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in case of parent companies and subsidiaries of Member States deals with the elimination of economic double taxation arising within a group of companies from cross-border distribution of profits, as well as the avoidance of double non-taxation resulting from the combined effect of the exemption of dividends in the Member State of the parent and the deductibility of the same dividends at the level of subsidiary in its Member State of residence. It mitigates economic double taxation by requiring the state of the parent company to either exempt the dividend distribution or grant an indirect credit for the taxes paid by the subsidiary. It completely avoids juridical double taxation by obliging the state of the subsidiary to refrain from levying a withholding tax on the dividend distribution. Therefore, the Directive seeks to abolish both tax impediments to cross-border payment of dividends within groups of companies, improving the functioning of the internal market, especially the free movement of capital and the freedom of establishment. The preamble to the Directive refers to the need to introduce tax rules which are neutral from the point of view of competition ‘in order to allow enterprises to adapt to the requirements of the common market, or increase their productivity and to improve their competitive strength at the international level’. Specifically, the Directive seeks to eliminate the tax disadvantage suffered by companies from different Member States, by comparison with companies of the same Member State, where they seek to cooperate by forming groups of parent companies and subsidiaries. The objective scope each Member State shall apply the Directive is determined under Article 1(a) and Article 1(b).

To refer to any kind of transfer of benefits from a qualifying subsidiary, resident in a Member State, to its qualifying parent company, resident in another Member State, the term used is ‘distribution of profits’. Dividend income, distributed out of subsidiary profits already taxed,

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and received by (a branch of a qualifying parent company in another Member State, must not suffer economic double taxation in the hands of that (branch of the) parent company.\textsuperscript{56} The application of the directive requires a holding relationship between the companies involved. The Member States must not set any conditions that are not mentioned in the directive for a taxpayer to benefit from the elimination of double taxation.\textsuperscript{57} It provides either the exemption method, where the Member State of the (branch of the) parent company must either refrain from taxing the dividend income; or the indirect credit method, where the Member State of the (branch of the) parent company may tax the dividend, but allow the (branch of the) parent company to deduct from its corporation tax due, the amount of tax paid by the subsidiary in its State of residence on the profits out of which the dividend was paid.\textsuperscript{58} Each state has the sovereignty to choose the method most suitable and each contracting state will agree on the method which will apply.\textsuperscript{59}

Distributions of profits by subsidiary companies in favor of their parent companies resident in other Member States are included under Art. 1(b). The main rule is clearly stated under Article 5 of the Directive, which provides that the Member State of the subsidiary shall exempt qualifying dividends from withholding tax. It has direct effect and can therefore be relied upon by individual taxpayers before national tax courts with priority over derogating national tax law. Exemption at source is mandatory and Member States are not permitted to provisionally levy a withholding tax at the time of the distribution and refund it to the parent company only after the latter has applied for such refund and has demonstrated that it is qualifying parent company.\textsuperscript{60} It is then Article 6 that imposes on the Member State of the parent company, the obligation not to charge withholding tax on the profits which a parent company receives from a subsidiary.

It was the first revision in 2003\textsuperscript{61} that extended the scope of the Directive to permanent establishments and to the SE. The 2003 amendment updated the list of companies covered by the PSD, relaxed the conditions for exempting dividends from withholding tax (i.e., a

reduction in the participation threshold) and eliminated double taxation for subsidiaries of subsidiary companies⁶². A following revision was introduced in 2014⁶³ in order to counter double non-taxation rising due to the combined effect of the exemption of dividends in the Member State of the parent and the deductibility of the same dividends at the level of the subsidiary in its Member State of residence. The last revision is the one of 27 January 2015 that introduced a general anti-abuse clause⁶⁴. Article 1(2) of the “former” Directive merely authorized but did not require Member States to apply existing anti-abuse rules within the scope of the Directive. This “authorization” was no longer considered to be enough for two reasons. First, such domestic or treaty-based provisions may have different levels of severity and are designed to reflect the specificities of each Member State’s tax system. Second, there are Member States that have not taken any legislative steps to adopt the anti-abuse rules whatsoever. Without transposition into domestic law, the anti-abuse rule “authorization” cannot have legal effect⁶⁵. The insertion of a common minimum anti-abuse rule would thus aid in preventing misuse of the EU Parent-Subsidiary Directive and, at the same time, ensure greater consistency in the application of the PSD. With the adoption of a general anti-abuse rule in the EU Parent-Subsidiary Directive (2011/96), the EU legislator has reinforced the position of EU Member States in countering abusive practices.

III. How Albania tax legislation compares to the Parent-Subsidiary Directive?
Considering the obligations that arise from the objective of becoming a EU Member, Albania has experienced for more than fifteen years intensive reforms to approximate its legislation with the European Union. Of course, this is not an unprecedented effort, but for Albania such effort has a challenging character if the lack of tax administration is considered from which and on which the Albanian legislation has been established since 1991⁶⁶. Regardless of the highly discouraging basis, the objective of Albania has been consistent and well determined: the approximation of the domestic legislation with the EU law or the acquis communautaire.

⁶⁶ “Since 1969, time when Albania was proclaimed the only country in the world with no taxation, until 1991, time when first customs elements were re-established, there was a total lack of tax administration.”
and the significant redefinition of the relation between Albania’s domestic law and European Law. Against this background, tax legislation in Albania has been subject to constant reforms. Albania seems to be the example of a state that tries to adapt as much as possible to the objectives and goals of the EU's legal instruments, without having the obligation to do so, at least at the current stage of the integration process. The purpose of this section is to discuss how far the Albania tax legislation has developed in achieving the objectives of the Parent – Subsidiary Directive on eliminating double taxation.

Seen from the perspective of PSD, Albania is a third country. Prior literature is in general focused on what PSD stipulates with respect to third countries. This section however focuses on a third country’s constant efforts to approximate its legislation with the *acquis communautaire*, and to approach the objective and subjective scope of the Directive.

The main goal is to understand the intensity with which Albanian direct tax legislation conquers double taxation that might arise in cross-border distribution of profits.

### 3.1 Albania’s effort on the elimination of double taxation

Domestically, the method chosen for the elimination of the double taxation depends mainly on the general tax policies and on its tax structures. When it comes to developing countries, usually the methods used in developed countries are not very suitable to them. For instance, one of the main shortcomings for developing countries when using the indirect credit method, is the fact that low taxation for countries in development, or application of special taxes, in most of cases might harm incomes from exports and imports, instead of helping foreign investors. Albania, as both a developing country and a non-member State of European Union, but in the light of approximation of tax legislation to the *acquis communautaire*, has taken its own steps in preventing double taxation, using state-by-state cooperation. Albania has concentrated its efforts on the elimination of double taxation in two main channels: double tax treaties (DTT) and regional co-operation. Regional co-operation on tax policy oriented on elimination of double taxation, is a common path of South Eastern European economies to harmonize their current frameworks and practices and maximize tax revenues

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69 DTTs often provide an exemption system under conditions which are less strict than the ones applicable under the EU Parent-Subsidiary Directive, either because the residence criteria are less strict or because there is no condition as regard as the holding period. Generally however, the level of shareholding required under the DTTs is slightly higher (often 25%) than the one required under the EU Parent-Subsidiary Directive (10%). See Remacle, O., & Nonnenkamp, S. (2011). Economic Double Taxation as an Obstacle to Cross-Border Investments, in Rust, A. (Ed.). (2011). *Double taxation within the European Union*. Kluwer Law International, p. 22.

Electronic copy available at: https://ssrn.com/abstract=3718703
without running the risk of a race to the bottom\textsuperscript{30}. On the other hand, double tax treaties provide legal certainty regarding the taxation of cross-border trade and activities, eliminating double taxation. The adoption of tax treaty provisions, based on the OECD’s model treaty\textsuperscript{71} or the UN’s double taxation model agreement\textsuperscript{72}, is Albania’s strategy to address the most common issues in the field of double taxation in accordance with tax treaty policies adopted by other countries.

In case of Albania, the elimination of double taxation has an extraordinary stimulus. It goes beyond the purpose of simply removing obstacles to cross-border investments in order to adapt in advance to European legislation to ensure free movement of capital and goods in international transactions. Taxation is an important factor influencing foreign direct investment in developing countries. Mostly starting from 2000, Albanian governments have undertaken a wide range of structural reforms to create an international competitive business environment and to align the growth opportunities with the needs of foreign investors.\textsuperscript{73} Albania maintains a liberal foreign investment regime designed to attract FDI. The Law on Foreign Investment\textsuperscript{74} outlines specific protections for foreign investors and allows 100\% foreign ownership of companies. Amendments in 2017 and 2018 extended state protection for strategic investments as defined under the 2015 Law on Strategic Investments\textsuperscript{75}. Being the legal framework for investment the cornerstone of an enabling investment environment, Albania maintains only a handful of restrictions, making its FDI regimes less restrictive than that of the average OECD economy and it compares favorably against the average of the 22 EU Member States covered by the OECD FDI Regulatory Restrictiveness Index\textsuperscript{76}. As such,

\textsuperscript{72} See UN. (2017). United Nations Model Double Taxation Convention Between Developed and Developing Countries. UN.
\textsuperscript{74} The Law on Foreign Investments seeks to create a hospitable legal climate for foreign investors and stipulates:
(i) No prior government authorization is needed for an initial investment;
(ii) Foreign investment may not be expropriated or nationalized directly or indirectly, except for designated special cases, in the interest of public use and as defined by law;
(iii) Foreign investors enjoy the right to expatriate all funds and contributions in kind from their investments;
(iv) Foreign investors receive most favored nation treatment according to international agreements and Albanian law.
\textsuperscript{76} The OECD FDI Regulatory Restrictiveness Index to assess and benchmark market access and exceptions to national treatment. This index gauges the level of restrictiveness of an economy’s statutory measures on FDI by looking at four
the rules concerning foreign investors are unlikely to constitute a major impediment to attracting investments in Albania. The prevention or the elimination of international double taxation in respect to the same income, constitutes a significant component of such a positive climate. Tax treaties for the elimination of double taxation between Albania and developed countries enhance the attractiveness for MNEs to invest in Albania. Tax treaties between developed and developing countries are the instrument to replace the shared allocation of taxing powers with exclusive allocation to the largest extent possible, which prevents double taxation in relations with developing countries rather than giving relief for it. Although the direct tax benefits of a bilateral tax treaty for a foreign investor are limited, it appears that the signaling role they play is likely to be of high significance in attracting investment. If the main role of tax treaties is to bring ‘international economic recognition’ or act as a ‘badge of international economic respectability’, the benefits they bring should compound as a country’s treaty network grows.

Albania is moderately preparing the network of International Conventions with many international institutions, governments and international financial institutions for the avoidance of double taxation. It started to conclude double tax treaties for the avoidance of double taxation and prevention of fiscal evasion in 1993, when the first DTT was signed with Hungary. As of June 2020, the Parliament of Albania (Kuvendi) has ratified 43 International Agreements for the avoidance of double taxation and prevention of fiscal evasion, of which 41 are currently in force and 22 out of them are with EU countries. In general, agreements cover the taxation of income from business profits, international transport, dividends, interest, royalties, dependent and independent personal services, as well as income from real estate. They are based on a sample project approved by the Government, pursuant to the international models drafted by the United Nations and the OECD. Each bilateral agreement considers tax peculiarities, as well as economic and trade relations of both countries.

Regarding the avoidance of double taxation, the Albanian model agreement is a mixture of the OECD Model Convention and of the UN Model Convention. Usually, Albania employs,

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main types of restrictions: 1) foreign equity limitations; 2) discriminatory screening and approval mechanisms for foreign investment; 3) restrictions on the employment of key foreign personnel; and 4) other operational restrictions.


80 See the list of agreements provided by The General Directorate of Taxation. https://www.tatime.gov.al/eng/c/8/125/international-agreements

81 DTTs with Marocco (October 2015) and Saudi Arabia (February 2019) are signed but not entered into force.

82 There is no a double tax treaty with Denmark, Cyprus, Finland, Portugal, Slovakia and Lithuania.

the credit method, while, other countries, on a case-by-case basis, refer to the method of exclusion, or method of accreditation, or, in some cases, a combination of both.

Dealing with double taxation is a relatively new phenomenon for the Albanian taxpayers. In practice, taxpayers are facing an increasing number of cases where the implementation of the provisions of the tax treaty remains on hold until the exchange of information procedures between the tax authorities of both contracting states are concluded. Provisions of a tax treaty prevail only when an application is filed by the Albanian taxpayer requesting a benefit under such treaty, i.e. exemption from withholding tax or obtaining an authorization to apply a reduced rate. In order to enjoy the benefits of the double tax treaties, the taxpayers must bring evidence regarding the residency in Albania or in the other contracting state. All the International Conventions for the avoidance of double taxation signed by Albania prevail over Albanian domestic tax law.

However, especially when it comes to double tax treaties, there is a substantial lack in the Albanian legislation on corporate income tax when referring to different forms of distribution of profits. Such a case is when referring to the taxation of capital gains, deriving from sale of shares in Albanian entities. For instance, when a double tax treaty is in place between Albania and the country of residence of the shareholders to whom the gains are distributed, the provisions of the treaty will prevail over the Albanian domestic law. As such, if the treaty provides for the exemption of such profits from tax in Albania, this provision will prevail. However, double tax treaties are not automatically applied in Albania. The General Tax Directorate has the sole authority to approve the application of treaty provisions for all specific circumstances of taxpayers after the latter follow certain application procedures to benefit from exemptions, reduced rates and credits. In this case, it is unclear whether the obligation to follow said procedures for obtaining approval of exemption from capital gains tax in Albania lies with the non-resident shareholder, or such exemption applies automatically. In practice, in a few cases, Albanian tax authorities have charged the Albanian entities whose shares were traded, with withholding tax liabilities on behalf of the non-resident shareholders. The situation is even more unclear for capital gains of shareholders resident in countries with which there is no double tax treaty in place.

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84 Article 10, Article 16 and Article 17 of Law no.8560 of date 22.12.1999, Republic of Albania.  
3.2 Subjective Scope of the Directive in Albanian tax legislation

3.2.1 ‘Company of Albania’

Pursuant to the ‘principle of residence’, priority to tax treatment is provided to entities, not to the country where income is generated. The Albanian (personal and corporate) income tax system is based on the world-wide income principle. Companies that are incorporated in Albania or that have their place of effective management in Albania, are subject to corporate income tax on their worldwide income as considered Albanian companies. A company is a resident of Albania if its principal legal seat or place of effective management is in Albania.86 Partnerships and legal entities with a permanent establishment in Albania are considered residents for tax purposes. All foreign companies that generate profits from activities performed through a permanent establishment in Albania are subject to tax on those profits. Taxable income of residents includes business profits, as well as dividends, interest and capital gains.87

Companies constituted under the law of Albania and subject to corporate taxation therein are all commercial companies of Albania (‘shoqëri tregtare’). Resident entities must register with the National Business Center (NBC)88. Foreign and domestic investors have numerous options available for organizing business operations in Albania. The 2008 ‘Law on Entrepreneurs and Commercial Companies’89 and ‘Law Establishing the National Registration Center (NRC)’90 allow for the following legal types of business entities to be established through the NRC: Sole Entrepreneur; Unlimited Partnership; Limited Partnership; Limited Liability Company; Joint Stock Company; Branches and Representative Offices; and Joint Ventures. If and when Albania becomes a Member State of the European Union, by virtue of Article 2(a) of the PSD, the term ‘company’, which is exhaustively defined in the Annex to the Directive by reference to concepts of national law, would have to adapt the (Annex to) the Directive by reference to concepts of Albanian national law, including in the list: “companies under Albanian law known as ‘shoqëri me përgjegjësi të kufizuar Sh.P.K’, ‘shoqëri aksionere Sh.a’, ‘shoqëri kolektive’, ‘shoqëri komandite’ and private and public entities whose activity

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88 For more details on the establishment of the business entities of the abovementioned legal types see the official site of the National Registration Center in Albania http://www.qkr.gov.al/home/
is wholly or principally commercial”, or “companies incorporated under the law of Albania”. In addition, according to Article 2(a)(ii) of the PSD, companies in one of the forms listed, ‘according to the tax laws of Albania must be resident in Albania for tax purposes’ 91. Satisfied both conditions, these companies, once considered companies of Albania, would be included in the subjective scope of the Directive and as such the clauses and benefits of the Directive would apply to them.

Article 18 of Law no.843892 defines all the exempted categories from corporate income tax in Albania. Exempt from corporate taxation in Albania are Central and Local Government Bodies and the Central Bank of Albania, Legal entities which conduct religious, humanitarian, charitable, scientific or educational activities, trade unions or chambers of commerce, voluntary pension funds managed by the management company of voluntary pension funds etc. Therefore, according to Article 2(a)(iii) of the Parent-Subsidiary Directive these are entities that have the possibility “of an option or of being exempt”. Thus, they cannot be subject to taxes listed in Annex I, Part B to the Directive, and as such they would not be included under the subjective scope ‘company of a Member State’ (assuming ‘company of Albania’). These companies would remain outside of the subjective scope of PSD.

3.2.2 Permanent Establishment in Albania
Additionally to ‘companies of a Member State’, the benefits of the Parent-Subsidiary Directive and its purpose applies also to Permanent Establishments, according to Article 2(b) of the Directive. If the definition of ‘permanent establishment’ in Albania complies with the one given in the Directive, then also Albanian Permanent Establishments would be considered as subjects to whom the Directive would apply.

The definition of ‘permanent establishment’ in Albania is provided for under Article 2 paragraph (2)(a)(b)(c)(ç)(d)(dh) of Law no.8438, Income Tax Law (ITL). The permanent establishment (PE) definition included in this law is generally in line with the OECD’s standards93. Permanent Establishment (PE) shall imply a fixed place of business through which the business activity of an enterprise is wholly or partly carried out either directly or through a dependent agent. A PE could include an administrative office, a branch, a factory, a workshop, a mine or any other place for exploitation of natural resources, as well as a building, reconstruction, installation or assembling site. The Albanian PE definition provides

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91 Article 2(a)(ii) of the Parent-Subsidiary Directive.
93 Philippou, E., Hoxha, R., & Global, E. Permanent establishment concept in Albania.
for no minimum time period for any of the above to be considered a PE\textsuperscript{94}. If there is a double tax treaty in place, the related PE definitions, including any time limitations, will prevail. Nonetheless, there is a procedure to be followed up with the General Directorate of Taxation (GDT) in order to be able to apply the rates provided by the double tax treaties. Looking at the compatibility of the definition of the term ‘permanent establishment’ in Albanian legislation with the definition of ‘permanent establishment’ under Article 2(a)(b) of the Parent-Subsidiary Directive, it is clear that once an administrative office, branch, factory etc., is defined as ‘permanent establishment’ in Albania, then in a future possible scenario it would be subject to the application of the Directive.

Some controversy arises between interpretations of Albanian tax advisors on the consequences of creating a PE in Albania as a result of managerial, professional, consultancy and other types of services provided herein. One interpretation is that the non-resident person has the obligation to register the PE with the Albanian tax authorities in the form of a branch (there is no option to formally register a PE as such). The registered branch would pay tax on income attributable to it in the form of corporate income tax. However, the registered branch would also trigger all other applicable taxes, e.g. VAT, social and health contributions and employment income tax, local taxes, etc., as well as other compliance obligations, such as for instance the preparation and audit of statutory financial statements. Another interpretation is that the non-resident person has no obligation to register the PE in the form of a branch, if the Albanian beneficiary of the services retains 15% withholding tax from the gross payment made to the non-resident and remits it to the Albanian tax administration. The PE in this case would not be allowed to deduct any costs in determining the amount subject to Albanian income tax. On the other hand, the PE would not typically be subject to other taxes and compliance obligations. Under this latter interpretation, the decision of whether to register the PE in Albania in the form of a branch remains at the discretion of the non-resident person and should not necessarily be driven by tax reasons\textsuperscript{95}.

### 3.3 Taxation of cross-border distribution of profits in Albania: a comparative approach with the Objective scope of the Directive

#### 3.3.1. Corporate Income Tax under Law no. 8438


Income taxes are one of the seven categories of national taxes and duties in the Albanian tax system. Income taxes are regulated by “Income Tax Law” (ITL), Law no.8438, date 28.12.1998 of the Republic of Albania. It divides income taxes in three forms: the personal income tax, the corporation income tax and withholding tax.

Article 16 of Income Tax Law (ITL) determines the subject of corporate income tax:

“companies or individuals engaged in independent business activities and any other person regardless of juridical form of registration which are registered as VAT taxpayers”97. Article 17 (“Obligation to pay”), of the same law determines the principle of worldwide taxation. Based on it, resident taxpayers are tax subjects on their worldwide profits, while non-resident taxpayers are subjects on the profits derived from sources in Albania. Taxable profit is defined as the difference between revenues and related expenses. The determination of the tax base starts with the profit shown on the balance sheet, which must be corrected for tax deductible and non-deductible expenses. As defined under the Article 18, deductible expenses are those who directly serve to business profits such as: depreciation allowances, rent, spare parts, insurance premiums, interests, representation expenses, etc. Expenses that are not deductible for tax purposes are defined under the Article 2198.

Capital gains from the sale of company’s fixed business asset are taxed as part of company’s ordinary business income. Losses may be carried forward over a period of three years.

3.3.2. Inbound Dividends

The treatment of the inbound dividends, as the primary objective scope of the Parent-Subsidiary Directive, is a crucial and relevant fact of interest for a holding company established in Albania.

Dividend income in Albania is considered as taxable income, unless the domestic participation exemption applies. Dividends and profit shares distributed by a resident company or partnership to another resident entity are not included in the taxable income of the recipient, provided that both the distributing entity and the receiving entity are subject to profit tax99. Therefore, for inbound dividends distributed to an Albanian holding company by its subsidiaries, Albania tax system follows the participation exemption as a form of double

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96 The corporate income tax (CIT) rate in Albania is 15%. CIT is assessed on the taxable profits calculated as taxable income less deductible expenses. Taxpayers with annual turnover up to 5 million Albanian lek (ALL) are exempt from CIT, whereas taxpayers with annual turnover from ALL 5 million to ALL 14 million are subject to a reduced CIT rate of 5%. Other taxpayers with annual turnover greater than ALL 14 million are subject to a 15% CIT rate.
tax relief, which prevents dividends and capital gains from being taxed twice. As such, dividend income and profits distributed by resident companies or partnerships are excluded from the taxable profits of the Albanian holding company if the payer is subject to corporate income tax in Albania, regardless of the extent of the recipient’s participation.

The participation exemption is not available for holdings in foreign companies. Therefore, foreign-source dividends are included in taxable income. The new fiscal package, which entered into force on January 1st, 2019, imposes a tax rate of 8% for all the retained earnings realized before 2018, including reserves and capitalized gains, provided that the tax related to retained earnings before 2017, was paid by September 30, 2019 and the dividend tax for profit for 2018 was paid by August 20, 2019. In case these conditions were not satisfied, the taxpayer would pay 15% tax on dividends. The decision to reduce the tax on dividends from 15% to 8% came with the Government fiscal package of 2019 in order to attract foreign investors in Albania.

Hence, Albania includes the foreign-source dividend income in the corporate income tax and a credit of foreign tax paid is available only if there is a double tax treaty in place with the country of the foreign subsidiary. Therefore, double taxation relief may be obtained either unilaterally or under a tax treaty. In both cases, an ordinary credit is granted for foreign taxes suffered on foreign-source income. The credit is calculated on a per-country basis. The foreign tax relief cannot exceed the Albanian corporate income tax charged on the same profits. If a company receives income from a country with which Albania has entered a double tax treaty, other forms of foreign tax relief may apply, as stipulated in the provisions of the treaty.

Hence, unless a double tax treaty is in place, the dividend exemption is not granted with respect to dividends received from foreign companies. Given that the purpose of dividend exemption is to encourage investment as a measure to prevent economic double taxation, then the denial of exemption to dividends received from foreign companies constitutes a restriction on the free movement of capital. Thus, it results in a situation in which holding of foreign shares are less favorable to Albanian residents than the holding of domestic shares.

101 For more information on the Government New Fiscal Package 2019, visit the official website of the General Directorate of Taxation in Albania https://www.tatime.gov.al/eng/
105 What the CJEU ruled out in June 6, 2000, Case C-359/98 (Verkooijen), ECR 2000, I-104071.
First, it keeps residents of Albania from investing their capital in companies established in other States. In addition, it has restrictive effects for companies not resident in Albania in terms of preventing them from raising capital, as it makes their shares less attractive to Albanian investors. Since Albania sets off the corporate income tax against the personal income tax on distributed dividends it has levied itself, there is no reason not to do the same as regards to corporate income tax levied by the State where the distributing company is resident. Hence, from the point of view of the Parent-Subsidiary Directive scope, although it should make no difference in which State the corporate income tax is levied, Albania applies a system to prevent economic double taxation in domestic situations, but it ignores the foreign income tax already levied on distributed profits. Therefore, Albania does not acknowledge other States’ corporate income taxes levied, unless a double tax treaty is in place. In such case, dividend income is subject to corporate income tax but credit of foreign tax paid, is offered only if there is a double tax treaty in place between Albania and the country of the foreign subsidiary. This causes for Albania to reduce its levies or additional levies. On this regard, Albania is in line with the Indirect Credit Method that the Directive suggests as an option for the State of the parent company, in order to fulfill its obligation of eliminating the economic double taxation arising in respect of the inbound distribution of profits. It taxes the profits while granting a tax credit for the corporate tax paid by the subsidiary and any lower-tier subsidiary. However, to remain within the purpose of the analysis, it is of importance to mention that this elimination of double taxation does not come as a result of the synchronization of direct taxation legislation in Albania with the objective of the Directive, but as the pure result of signing separate tax treaties with each country. Referring only to the 22 out of 27 EU States, it is clear that Albania applies simultaneously the exemption method for domestic dividends, but it provides no more than indirect credit for inbound cross-border dividends. This tallies perfectly with the OECD Model logic, but it might be perceived as running against the internal market logic since it has the distinct features of a discrimination against the cross-border investor. The Parent-Subsidiary Directive, although suggesting both methods, it does not allow their asymmetric application and asks for the same method for both cross-border dividends and domestic dividends.


107 CJEU indicated this in Case C-315/02 (Lenz), ECR 2004, I-104071 and Case C-319/02 (Manninen), ECR 2004, I-07477.


This reasoning leads to two main concerns: First, unless a country has a double tax treaty with Albania, Albania’s tax legislation does not exempt or provides for a credit for the foreign income tax already levied on the distributed profits by source of State. Secondly, even if a State has concluded a double tax treaty with Albania, a company cannot benefit from a more favorable treatment than the indirect credit method provides, simply because not being part of the EU, the Parent-Subsidiary Directive benefits cannot prevail over the double tax treaty provisions.

### 3.3.3. Outbound Dividends

Dividends paid to non-resident companies are subject to a final withholding tax on the gross amount at the rate of 8% (as of January 1st 2020), unless a treaty provides for a lower rate. In cases where a tax treaty exists between Albania and the country of residence of the foreign entity, the payment of withholding tax might be avoided or reduced. Therefore, this tax may be decreased to 5% or 0% if such payments are done to residents of countries with which Albania has a convention for the avoidance of double taxation. The reduced rates are applied according to the terms of each specific DTT. Hence, for outbound dividends, Albania tax legislation uses double tax treaties as its main channel for the avoidance of double taxation in cross-borders situations. Unless a double tax treaty is in place with Albania, the fact that only non-residents are subject to withholding tax, while the residents are liable to regular income tax, suggests that as the State of source, Albania obstructs non-residents in acquiring or benefiting from cross-border shareholdings. The reason for such concluding remark is that Albania levies a separate withholding tax from such non-residents. In this regard, it seems that in Albania, therefore in the State of source, resident shareholders and non-resident shareholders are not treated equally. As mentioned above, the withholding tax is not applicable if the recipient resident of Albania, due to the justification that such persons declare and pay income taxes in Albania. It reflects the same argument given by French authorities in the Denkavit International case concerning a withholding tax levied on dividends distributed by a French subsidiary to a shareholder resident in The Netherlands. French authorities argued that Denkavit International, being a non-resident shareholder, did not find itself in the same situation as a comparable but resident shareholder, since the later was subject to French corporate income tax whereas Denkavit International was not.

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112 See Case C-170/05 (Denkavit International), ECR 2006, I-11949.
refusing to extend to non-resident shareholders the more advantageous national tax treatment accorded to resident shareholders, the legislation regarding the levy of French dividend withholding tax resulted to be incompatible with Article 49 TFEU. Thinking in parallel, such concern arises in Albania where a DTT is not in place, since it is deemed to restrict cross-border shareholdings by imposing a higher tax on dividends of a non-resident shareholder of a resident company than it does on such dividend income of a resident shareholder.\textsuperscript{114} Only an exemption of the distribution of profits from withholding tax would prevent Albania from collecting a second layer of tax, in addition to corporate taxes levied in the hands of the subsidiary itself, thus preventing economic double taxation, as ruled out in the Article 5 of the Parent-Subsidiary Directive.\textsuperscript{115} Albania, as the state of the subsidiary exempts the withholding tax, but only if a double tax treaty, and not always, depending on the provisions of the respective tax treaty. It proves one more time the fact that Albania follows the majority of developing South-Eastern European countries, fighting the double taxation through double tax treaties. Nevertheless, approximation duties ask for more to be done on this direction. Albania comes close to what the PSD obliges for the State of source in order to eliminate the juridical double taxation, but it limits such effort only to the borders of double tax treaties, remaining silent towards states with which a double tax treaty is not in place, and as mentioned, 7 of these countries are EU Member States.

3.3.4. Anti-abuse reservation in Albanian tax legislation

With the adoption of a new general anti-abuse rule in the EU Parent-Subsidiary Directive, the EU legislator has reinforced the position of EU Member States in countering abusive practices. Hence, the successful enclosure of Albania integration process in European Union would strengthen the role of Albanian tax administration in preventing and countering the use of abusive tax avoidance schemes, adhering to the definition of “abuse” as provided in the GAAR contained in the Directive. In such future and potential context, Albania, based on the Article 1(2) of the PSD, would not grant the benefits of the Directive in case of abuse.

However, reasoning beyond the hypothetical context of the application of the Parent-Subsidiary in Albania as if it were a MS, let us contextualize the analysis in the current reality. It is of relevance to mention that Albanian law does not make a clear distinction between tax avoidance and tax evasion yet. Under the Article 116 of the Law on Tax

Procedures, tax evasion is the concealment or avoidance of taxes. Therefore, also decisions of the Supreme Court of Albania, are mostly related to tax avoidance in terms of committing tax evasion, which means they are by definition abusive practices.

Prior to January 2019, Albania tax legislation had not a general anti-avoidance rule included in it. There were several provisions that aimed to prevent and counter the use of abusive tax avoidance schemes and mechanisms. First, a primary role was attributed to the Law no.8438 on Income Tax which limits specific transactions that might be used artificially in order to reduce tax liability. Second, of crucial use was the Law on Tax Procedures, Law No.9920, which once it introduces the concept of ‘economic substance over form’, through the Article 71, it gives to the tax administration the right to use alternative methods of tax assessment when verifying the lack of economic substance in a transaction. Transfer pricing rules were themselves considered as anti-avoidance rules, described and regulated under by Article 36 of the same law. Related party definitions, transfer pricing provisions which provide the application of the arm’s length principle, thin capitalization rules and controlled transaction notices were designed in Albanian tax legislation in order to reinforce GAAR and any other abusive tax avoidance provisions in Albania.

The second tranche of the Fiscal Package 2019 brought substantial amendments, published in the Official Gazette no.183, dated 21.12.2018 and no.187, dated 28.12.2018. The amendments that were effective as from January 1st, 2019 (unless otherwise stated), brought significant changes in the Law on Income Tax, Law on Tax Procedures and Law on VAT. Other changes had an impact on excise duties and other national and local taxes. The main objective of the changes in the Law on Tax Procedures was the introduction of a general anti-avoidance rule (GAAR). Other measures were intended to enable and extend the range of alternative methods of tax assessment and reduce administrative and business costs. The general anti-avoidance rule in Albania tax legislation, allows the tax authorities to disregard actions and transactions that are fictitious, having regard to all the facts and circumstances, and that are proved as being undertaken for the purpose of obtaining a tax advantage in contravention of the principles of the tax legislation. Actions and/or transactions classified as fictitious, might be those that distort the principles of the tax legislation, that are not based on the market value principle, those that suffer from a lack of substantial economic effect and have a legal form that does not reflect economic substance, as well as those that contain elements intended to avoid or reduce tax. The burden of proof lies primarily with the tax

authorities, who have the right to re-characterize the action and/or transaction and calculate the tax liability based on alternative tax assessment methods\textsuperscript{117}.

**Conclusions**

For the purpose of the membership in European Union, Albania has experienced more than fifteen years of intensive reforms to approximate its legislation with the European Union. The aim of this article was to understand whether Albania, as an official candidate for accession in European Union since June 2014 and in the context of the approximation of its legislation with the *acquis communautaire* under the guideline of the Stabilization and Association Agreement, acts against the double taxation arising in cross-border distribution of profits, contributing in such a way not only to remove this obstacle to the free movement of goods and services and to the proper functioning of the internal market, but also to offer a favorable investment climate for both domestic and foreign investors.

Double taxation in a cross-border context is the result of inconsistent interaction of different domestic tax systems. Therefore, the Parent-Subsidiary Directive acts in favor of direct tax harmonization among the tax systems of different states, by providing a common system of taxation applicable in the case of parent companies and subsidiaries of Member States in order to eliminate economic double taxation arising within a group of companies from cross-border distribution of profits. It mitigates economic double taxation by requiring the state of the parent company to either exempt the dividend distribution or grant an indirect credit for the taxes paid by the subsidiary. It completely avoids juridical double taxation by obliging the state of the subsidiary to refrain from levying a withholding tax on the dividend distribution.

The comparison of Albania direct taxation on cross-border distribution of profits with the subjective and objective scope of the Directive testified that the elimination of double taxation has not been left out of the attention of Albanian tax legislation, but it follows a typical channel of developing countries, double tax treaties. It remains away from what Member States of EU are expected to do on this regard, as well as away from the purpose of direct tax harmonization.

Concerning, the treatment of the inbound dividends, unless a double tax treaty is in place, Albania applies a system to prevent economic double taxation in domestic situations, but it


ignores the foreign income tax already levied on distributed profits. Therefore, Albania acknowledges other States’ corporate income taxes levied only if it has a DTT signed with the State of source. For the cross-border distribution of profits from 22 out 27 EU countries with which Albania has DTT, as the State of residence, it applies simultaneously the exemption method for the domestic intercompany dividends, but it provides no more than indirect credit for inbound cross-border intercompany dividends. Therefore, unless a country has a double tax treaty with Albania, Albania’s tax legislation does not exempt or gives a credit for the foreign income tax already levied on the distributed profits by the State source. Furthermore, even if a State is in a double tax treaty with Albania, a company cannot opt for a more favorable treatment that the indirect credit method provides, simply because not being part of the EU, the Parent-Subsidiary Directive benefits cannot prevail over the double tax treaty provisions.

As regard as the outbound dividends, on which the Directive oblige the Member State of the subsidiary as the State of source to exempt qualifying dividends from withholding tax, Albania remains within the framework of the provisions of double tax treaties with each country. An Albanian entity which makes payments to non-registered entities for services it provides to the entity is required to withhold from the invoiced amount and pay withholding tax to the tax authorities, while the withholding tax is not applicable if the recipient of the income is another Albanian resident, company or individual entrepreneur registered in Albanian tax authorities. Only under a double tax treaty such withholding tax may be exempted or reduced. Removing the double tax treaty condition, this suggests that resident shareholders and non-resident shareholders are not in comparable position, although for the purpose of preventing double taxation they should be.

Double tax treaties provide certainty in the taxation of cross-border trade and activities, eliminating double taxation. The adoption of tax treaty provisions based on the OECD’s income and capital model treaty or the UN’s double taxation model agreement, is Albania’s strategy to address the most common problems in the field of double taxation in accordance with tax treaty policies adopted by other countries. Nevertheless, the goal of Albania is the approximation of tax legislation with EU law, and this calls for crucial steps under the assumption of ‘being a potential Member State’. Therefore, Albania would do better if, in its constant efforts to approximate its direct tax legislation with the acquis communautaire, approaches directly the objective and subjective scope of the Parent-Subsidiary Directive, instead of remaining in the limits of a country that counts double taxation issues. It would line up itself as a candidate country that is already prepared to fully agree on harmonizing its tax
legislation with EU Member State for the purpose of the functioning of the internal market. This would lead to a better investment climate for investors in Member States of EU, and would help the cooperation between Albanian and EU Member State companies, creating also an international competitive business environment.