



**AmCham Montenegro
Tax Committee**

Position document

June 2014

Dear Sir/Madam,

This document is the product of the American Chamber of Commerce in Montenegro (AmCham Montenegro) and its Tax Committee members. It reflects AmCham's position on the predictability of the Montenegrin Tax System and creating a stimulating business environment accordingly. The aim of this document is to identify the areas which should be addressed in order to improve the overall business environment in Montenegro. Hence, the actions that the Ministry of Finance of Montenegro has undertaken thus far, including the establishment of the Commission for Preventing the Grey Economy are perceived as an important step forward in achieving the same goal. However, further improvements are expected when it comes to creating a transparent and predictable business environment, which promotes the Rule of Law on all levels.

This document encompasses recommendations resulting from AmCham members' everyday experiences. The recommendations presented in the document reflect specific problems which stream from the current legal framework and practice in the area of Tax Policy.

AmCham's Tax Committee is prepared to cooperate intensively with the Ministry of Finance and the Tax Authority to provide more precise recommendations and assistance regarding any of the topics mentioned in the document.

TAX POLICY

1.1. Overview of the current legal framework and practice

Maintaining Continuity in Tax Policy – Montenegro should sustain its present tax framework, particularly the value added tax (VAT) and corporate income tax rates, in keeping Montenegro attractive for current and future investors. Discontinuity in tax policy would not contribute to creating/maintaining a predictable business environment. Also, sudden shifts in tax policy would not be a good signal for attracting foreign direct investments (FDI). Increasing tax rates would prevent investors from following previously adopted business plans, which can have a negative effect on retaining present investors and attracting new investors.

Amending Tax Legislation – Tax Laws are often adopted rapidly, leaving no time for both the Tax Authority and taxpaying entities to adapt to it. Additionally, the process of drafting amendments to the law is lacking in transparency. Likewise, there are cases when legal amendments are not followed by amendments of related bylaws. Tax bylaws need to be aligned with the laws in this area (especially in cases when bylaws are contradictory to laws). This would contribute to removing confusion and problems when implementing laws.

Finally, bearing in mind the Montenegrin EU perspective, the aforementioned harmonization plan should also encompass the harmonization of Tax legislation with the EU *Acquis*. We particularly stress the need to amend the Law on Value Added Tax (VAT), making it compatible with bylaws, eliminating old and inconsistent solutions still provided by this Law and aligning it with the EU Directive 2006/112/EC¹. Further alignments with EU Directives should be done with respect to implementing the provisions of Law on Corporate Income Tax on dividend payment, author reimbursement, and interests between dependent individuals.

Retroactive Implementation of Legal Amendments – In the previous period we witnessed cases of retroactive implementation of amendments to laws in the area of taxation. This practice results in increasing business uncertainty on the Montenegrin market and gives a negative impulse for attracting further FDI.

Discretion and the lack of transparency in implementing tax legislation – unpredictability of the business environment and inconsistency in implementing laws and regulations is recognized as one of the major hurdles to attracting FDI. Additionally, the discretion and inconsistency in implementing valid tax legislation by the Tax Authority or local self-government representatives hinders the business of foreign investors and creates additional costs. We are of the opinion that improving the communication between the Ministry of Finance and the Tax Authority would contribute to further reducing business unpredictability for investors on the Montenegrin market.

¹ Council Directive 2006/112/EC of 20 November 2006 on the common system of value added tax

1.2. Practical examples

- **VAT**

The decision on changing (increasing) the VAT rate was introduced in mid-2013 and entered into force shortly afterwards. Therefore, taxpaying entities were obliged to adapt software in a very short period of time, which resulted in increased business costs.

The Tax Authority was not ready to react to situations which could have been foreseen with the introduction of the higher VAT rate. Taxpaying entities had to wait for answers or clarifying interpretations for several months. An example is the correction of the tax base from the period when the VAT was 17% which are currently undertaken and fall under the new 19% VAT rate. Furthermore, some of the solutions are inconsistent with regards to their implementation and they create further administrative obligations, both from the Tax Authority and from the taxpayers.

The change in the VAT rate from 17% to 19% was introduced in the middle of the tourist season, when many holiday packages were already booked. As this decision was adopted and implemented with very short notice, businesses were not able to change their offers and terms for holiday packages that were already booked. Consequently, these taxpayers had to bear further costs related to the aforementioned increase.

- **Excise**

In the second half of May 2013, businesses were introduced on a public debate session to the new Draft Law on Amending the Law on Excises. This Draft Law significantly differs from the Draft Law on Amending the Law on Excises which was recommended to the Government for adoption. The lack of transparency may contribute to market disorder and it represents the negative impulse with regards to investment planning for future domestic and foreign investors.

- **Corporate Income Tax**

Banks in Montenegro did not obtain final information if missing credit risk reserves would be treated as a deductible item in the current income tax calculation for 2013. The deadline for the final 2013 reports for the Central Bank of Montenegro is February 15, 2014. Furthermore, the deadline for internal reporting is typically January 15.

Another example is the absence of clear instructions on how to implement the norms of the Agreement on avoiding double taxation, hence the manner for determining the market prices for establishing transfer prices. This causes tax differences between companies and is a clear signal of unsafe business climate for investing.

- **Personal Income Tax**

At the beginning of 2013, a change in the tax rate for personal income based on employment was introduced with very short notice (introduction of the progressive taxation for the personal income higher than 720€ gross). The mentioned change resulted in further costs for employers, as well as in further reducing the demand based on the purchasing power.

- **Tax on Insurance Premiums**

The amendment of the Law on Insurance Premiums was submitted to the Parliament on November 25, 2013, adopted on December 23, 2013 and came into force on January 1, 2014.

By increasing the tax burden, i.e. by introducing a tax to goods which were exempt from paying taxes, the demand for these goods was further reduced. Likewise, the sales volume in an already weak insurance market is also reduced.

The reduced sales volume cannot be amortized in a short period of time by reducing fixed costs. At the same time, the increase of variable costs takes place in attempting to compensate the reduction of sales volume. Consequently, a loss is generated.

On the other hand, unpredictability of the tax system creates problems in doing business, such as the inability to introduce software changes or technically implement changes of taxes. This contributes to delays in sale and increase of the total loss.

- **Inconsistency in interpreting the tax legislation between the Ministry of Finance and the Tax Authority**

It is evident that there is inconsistency between the Ministry of Finance and the Tax Authority when it comes to their positions on certain tax related questions. Likewise, the tax payers often face situations when the adopted opinions are not implemented by the Tax Authority.

One of the examples is the VAT calculation for services of foreigners and acknowledging the right to deduction of the previous tax. The Rulebook on filing tax registration allows for using the right to VAT deduction for the same time period during which the calculation of the obligation was made. Many previously issued opinions also confirm this position. However, during the tax control of one of members, the tax inspector was of the opinion that paying VAT is a precondition for acknowledging the entry VAT, stating the norms which are not relevant for resolving the mentioned issue.

- **Implementation of norms of the Agreement on Avoiding Double Taxation (Agreement)**

Some Tax Authorities require that the corporate income tax paid abroad for income which should be taxed in Montenegro is the basis/precondition for implementing the Agreement on Avoiding Double Taxation. It is evident that this is a case of inadequate implementation of signed contracts. The mentioned request is not in accordance with the OECD methodology and practice of majority of the countries from the region and the EU member states.

1.3. Recommendations for improvement

- Plan realistic time frames for public debate on draft laws and timely announcements of planned law amendments through clear mid-term tax policy. AmCham recommends that the time frame should not be less than one year.
 - Introduce additional clarifications of amending proposals which are the result of public debate, which would align the adopted amendments with defined goals and in accordance with the overall tax policy.
 - Determining a certain timeline from the moment (day) when the legislation is adopted until it enters into force. AmCham recommends that this timeline should not be less than one year. Alternatively, a shorter deadline should be clearly defined and applied only for extreme situations.
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- Forming an operative group which would gather experts in taxation and representatives of the Ministry of Finance and the Tax Authority, with the aim of easier, more precise and timely implementation of adopted tax measures. This would contribute to finding more practical and simple solutions for the implementation of adopted tax measures. A sound example can be found in the neighboring Serbia, where the Council of Tax Authority Directors was formed in 2013. Members of this body are state authorities and representatives of companies, universities and business associations. Based on their experience in practice, this body gave recommendations for improving the work of the Tax Authority.
 - When implementing tax legislation, the following should be planned in advance: 1) the time required for both Tax Authority and taxpayers to prepare; 2) introducing rules (defined by bylaws) which would enable the implementation of law amendments. Finally, it is necessary for the Tax Authority to be equipped with the required technical support (such as software) which would enable it to implement law amendments in an adequate and timely manner.
 - It is necessary to determine exact objective parameters for implementing tax legislation and therefore enable the planning/budgeting of tax obligations, as well as supervising the budget implementation. This suggestion would be a precondition for equal development of certain local self-governments in Montenegro, by increasing transparency and aligning the parameters for determining tax obligations and other obligations based on fees determined by the self-governments.
 - Introduce continuous training programs for Tax Authority staff, aiming at harmonizing the implementation of tax legislation, which would contribute to the unification of law implementation between the civil servants from the Ministry of Finance and the Tax Authority.
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