

23 September 2013

Screening report

Montenegro

Chapter 16 – Taxation

Date of screening meetings:

Explanatory meeting: 8-9 April 2013

Bilateral meeting: 29-30 April 2013

I. CHAPTER CONTENT

The **indirect taxation** *acquis* consists primarily of harmonised legislation in the field of Value Added Tax (VAT) and excise duties. *Value Added Tax* includes the application of a non-cumulative general tax on consumption which is levied on all stages of production and distribution of goods and services. The VAT *acquis* provides for an equal tax treatment of domestic and non-domestic transactions. VAT is also based on the neutrality principle whereby the tax applied is proportional to the price, whatever the number of intermediate transactions.

In the field of *excise duties*, the *acquis* contains harmonised legislation as regards energy products including electricity, tobacco products and alcoholic beverages. EU legislation establishes the structure of the excise duty that should be charged, together with a system of minimum rates for each product group. Goods are subject to duty when they are produced within the EU or imported from a third country. However, in principle, the duty is payable only to the Member State in which the goods are released for consumption (with certain limited exceptions), and at the applicable rates in that Member State. The EU legislation lays down provisions on production, holding, movement and monitoring of excisable goods, as well as provisions on travellers' allowances. As regards excise products, their holding and movement for commercial purposes within the Internal Market continues to be closely monitored to establish the chargeability of the duty.

The *acquis* in the area of **direct taxation** concerns certain aspects of profit taxes and the avoidance of double taxation. The focus is on eliminating distortions for cross-border economic activities between enterprises within the Union. It also includes provisions to ensure effective taxation of income from savings in the form of interest payments made to individuals. The *Code of Conduct* for business taxation represents a political commitment by Member States to tackle harmful tax competition. Member States are required not to introduce new harmful tax measures, and to roll-back existing ones.

The EU legislation in the field of **administrative co-operation and mutual assistance** between Member States' tax and customs authorities provides tools to share information in order to prevent tax evasion and tax avoidance. It allows, for example, exchanging tax information automatically, spontaneously or upon request.

The *acquis* in the field of **operational capacity and computerisation** covers different areas of taxation. The *acquis* on the Value Added Tax Information Exchange System (VIES) provides for direct electronic interchange of data between national VAT administrations. This allows national administrations to monitor and control intra-EU trade and detect possible irregularities. In addition, a specific IT system (VoES) is required to establish the inter-connection for exchange of information among Member States related to the special scheme for e-Services provided by non-EU traders to EU citizens. Regarding excise duties, the *acquis* requires IT systems to allow Member States to exchange information on producers and traders of excisable products (Excise Movement and Control System - EMCS and its supporting systems¹: the European register of operators (SEED) and the system for monitoring *Central Services / Management Information System for Excise* (CS/MISE)). In the area of direct taxation, Member States are required to put in place a system of automatic exchange of information for five categories of income (income from employment, directors' fees, pensions, life insurance products and immovable property) and for savings income in the form of interest payments through an electronic standardised format.

¹ The Movement Verification System – MVS will be phased out by early 2014; its functionality will be covered by EMCS.

II. COUNTRY ALIGNMENT AND IMPLEMENTATION CAPACITY

This part summarises the information provided by Montenegro and the discussion at the screening meeting. Montenegro accepted the *acquis* regarding Taxation, stated that it is committed to continue to align with the *acquis* in the area of taxation, and committed to continue implementing the aligned areas. Montenegro indicated that its biggest challenges are to keep up a high pace of alignment with the EU *acquis* and to further build and improve its administrative capacity and develop its IT systems for the tax administration.

Montenegro stated that its tax system is mainly based on the following legal framework:

- Tax administration: *the Law on Tax Administration*² which contains the main tax procedures; the *Law on Integrated Registration and Reporting System on the Calculation and Collection of Taxes and Contributions* which concerns the Central Register containing mainly the persons liable for personal income tax and persons liable for compulsory social insurance payments.
- Direct Tax laws: the *Law on Personal Income Tax*³ which concerns income tax generated by natural persons; the *Law on Corporate Profit Tax*⁴ on the taxation of profit generated by legal entities; *the Law on Immovable Property Tax* on the taxation of immovable properties.
- Indirect Tax laws: the *Value Added Tax Law*⁵ on value added tax; the *Excise Law*⁶ on excise duties; the *Law on Tax on Immovable Property Transactions*, which concerns the taxation of the transactions of used immovable property.
- Other fiscal related laws: the *Law on Contributions for Social Insurance* on contributions for pension and disability insurance, health insurance and insurance against unemployment; the *Law on Financing of Local Self-Government*; the *Law on Administrative Fees*.

According to Montenegro, total tax revenues account for almost 40% of annual GDP. Tax revenues are split between central authorities (around 36% of GDP) and local authorities (around 4% of GDP). The biggest contributors to the State revenues are VAT (35% of State revenues), social contributions (30%), excises (13%) and personal income tax (9%).

As regards *institutional organisation*, the 'Department for Tax and Customs System' in the Ministry of Finance is in charge of Taxation. It is the regulating authority. Its head is the Deputy Minister of Finance for Tax and Customs System. The 'Tax Administration', which is the implementing authority, is another department within the Ministry of Finance and it has 650 staff. The head of the 'Tax Administration' is responsible to the Deputy Minister of Finance for Tax and Customs System.

II.a. Indirect taxation

Montenegro stated that it introduced the **Value Added Tax** in 2003, replacing a tax on trade of goods and services. Montenegro's Value Added Tax Law is based on the EU's 6th VAT Directive (77/388/EEC) and other EU directives. Montenegro informed that its legislation has not been adapted to Directive 2006/112/EC which replaced the 6th VAT directive.

² Official Gazette of the Republic of Montenegro 65/01 and 80/04; Official Gazette of Montenegro 20/11 and 28/12

³ Official Gazette of the Republic of Montenegro 65/01, 37/04, 78/06; Official Gazette of Montenegro 86/09, 14/12 and 06/13

⁴ Official Gazette of the Republic of Montenegro 65/01 and 80/04, Official Gazette of Montenegro 40/08, 86/09 and 14/12

⁵ Official Gazette of the Republic of Montenegro 65/01, 38/02, 72/02, 21/03, 76/05, and Official Gazette of Montenegro 16/07

⁶ Official Gazette of the Republic of Montenegro 65/01, 38/02, 76/05; Official Gazette of Montenegro 76/08, 50/09, 78/10, 61/11 and 28/12

According to Montenegro, the taxable transactions are the supply of goods and services within Montenegro and the import of goods. Trade of goods and services is taxed at the place of consumption, in line with the principle of destination. Trades of the following goods are not VAT taxable: land, used buildings and used passenger vehicles. Montenegro reported some problems on their definition of newly constructed buildings, used passenger vehicles, on the determination of the value of land and the value of the building constructed on it, and on the proper classification of operations as business to business (B2B) or business to consumers (B2C) in some services in international transport and also in engineering and advertisement.

There are VAT exemptions with the right to deduct input VAT for exports and assimilated transactions, and for delivery of medicines and medical devices funded by the Republic Health Insurance Fund (RHIF).

Taxable persons are all subjects with independent business or running a business delivering goods and services, or with a business operation related to the delivery of newly constructed buildings or the import of goods. Public institutions are also VAT taxpayers if they supply goods and services taxable in the case of other taxpayers as, for example, in the supply of electricity and water. VAT registration is mandatory for resident persons with turnover higher than EUR 18.000.

Services of public interest such as the health care system, social security, education and culture are VAT exempted. There are also VAT exemptions for insurance, banking and financial services, real estate trade, except for the first transfer of disposal rights, and for gold and other precious metals procured by the Central Bank of Montenegro.

There are special VAT schemes for: small entrepreneurs, agricultural producers, travel agencies and for intermediaries in the sale of used products, artistic items, collections and antiques. Small entrepreneurs selling less than EUR 18.000 annually are not obliged to register for VAT and have no right to VAT deduction. Agricultural producers selling less than EUR 18.000 annually are entitled to a 5% lump sum of the sales price of their products, and the buyer is granted a tax credit for the purchase of those products. Intermediaries of used products, artistic items, collections and antiques are subject to a special scheme, but they cannot deduct input VAT.

Montenegro indicated that the taxable event is the moment when the supply of the goods or services takes place, or the import of goods. It would be the moment of payment if the payment is made before the delivery, such as in the case of an advance payment.

The tax liability is determined by withholding "tax on tax". The taxable amount, or tax base, is the sale amount of the supplied good and services (in which VAT is not included) or in imports the value of goods assessed by customs regulations. The tax base includes excise and other taxes, fees, customs duties and other import duties except VAT, and includes indirect costs, such as wrapping, transport and insurance costs, calculated by the supplier and charged to the recipient. The tax base does not include the discounts approved at the moment of supply or the amounts which the taxpayer receives from the client for costs paid on the client's behalf.

Montenegro stated that the standard rate is 19% from 1/7/2013. The reduced rate is 7% and covers staple foods (milk, bread, fat, oil and sugar); medicines not covered by the RHIF; books, teaching aids, and serial publications; accommodation services in hotel and touristic lodgements; drinking water, except bottled water; newspapers; public transportation of passengers; public hygienic services, funeral services and related products and services; copyrights in the field of education, science, art, artefacts, collections and antiquities; services for shows, cinema, exhibitions and cultural and sportive events; use of sport facilities for non-profit purposes; fodder, fertilisers, pesticides, reproduction seeds, seedlings and breeding stock.

Montenegro stated that its list of reduced VAT goods and services is aligned with the *acquis*. Montenegro also indicated that it applies a reduced VAT rate for maintenance services supplied in marinas and for computer equipment, but only until Montenegro's date of accession.

VAT on imports is subject to the same treatment as that of domestic products. Nevertheless some imported goods enjoy VAT exemption when they are brought to Montenegro within the transit customs procedure, as temporary imports, reimports, imports in customs free zone warehouses or under diplomatic exemption; in the case of goods specially produced for education, training and employment of blind and deaf persons or other disabled persons; in the case of products imported by charitable organisations and organisations of disabled persons; and in the case of non-commercial goods, such as those included in Montenegro's travellers' allowances and gift parcels sent from abroad to natural persons.

VAT taxpayers are required to keep accounting, issue receipts of every sale and every pre-payment, submit VAT returns, and pay the net amount between output VAT and input VAT upon submission of their tax returns. The law prescribes minimum elements that a receipt must contain to identify the supplier and the client, and the specifics of the sale, including the rate and amount of VAT. The law foresees the possibility of using electronic invoicing, but requires a previous authorisation from the Tax Authority. Up to now there have been no requests or authorisations for electronic invoicing. The book-keeping requirements establish keeping records for issued invoices and input invoices, and for data on input and output VAT and for input and output VAT data according to rates.

VAT taxpayers must declare and file monthly tax returns assessments. Returns shall be submitted until the 15th day of the month following the tax period, when the tax liability must be paid. Upon imports, VAT is paid simultaneously as customs duty. VAT tax credits are refunded within 60 days of submission of the VAT calculation return.

Montenegro's **excise duties** legislation was enacted in 2002 in the Law on Excise Tax. Complementary legislation include, amongst others, the decrees on marking of tobacco and alcoholic beverages with fiscal stamps, the decree and the rulebook setting the procedure for determining the most popular price of cigarettes, the rulebook on the implementation of the Law on Excise Tax, the rulebook on the excise refund system on mineral oils for agricultural and forestry machinery, and the rulebook for marking mineral oils used as heating fuel.

Excise duties apply to alcohol, tobacco, mineral oils, coffee, and carbonated water imported to Montenegro or produced domestically. Exported goods are not taxable. The tax liability incurs at the moment when the producer releases the excise goods into free circulation, or in the case of imports, at the moment the customs debt arises. There is a deferred excise tax payment regime for excise warehouses and free zones.

Excise duty is calculated by the taxpayer on a monthly basis and the tax return is submitted to the tax authority by the 15th day of the current month for the tax liabilities of the previous month. The liability to account for excise tax on cigarettes shall arise on the day of takeover of the control of excise stamps. Excise tax on cigarettes, domestic or imported, is paid on the 60th day following the aforementioned day.

Certain products used for determinate purposes give the right to a refund of a part of the paid excise tax (e.g.: diesel used for industrial and commercial purposes, of mineral oils used as propellants for agricultural and forestry machinery, and of gas oils used for heating). The tax administration charges the higher excise for the release for consumption of a product. When the product is consumed for one of the purposes that allows for a reduced rate of excise, the user can claim a refund of the excise paid in excess.

Excise duty on imports or sales is waived or refunded in the following cases: sales outside Montenegro, sales to diplomats, sales to ships and aircrafts on international routes and duty-free shops, non-commercial products brought by travelers coming from abroad in their personal luggage within the limits of the personal traveler allowances, and fuels in the standard reservoirs of vehicles incoming from abroad.

Traveler allowances apply for tobacco products as follows: 200 cigarettes, or 100 cigarillos, or 50 cigars, or 250 grams of smoking tobacco, or a proportional quantity of some of the various tobacco products; for alcoholic beverages: 2 liters of wine and 1 liter of spirit; for perfumes: 50 grams, or 0.25 liters of eau de toilette. Articles imported under the personal allowance for travelers cannot exceed EUR 150 in value.

Excise duty rates on *alcohol and alcoholic beverages* are the following: for beers: EUR 5 per content of alcohol by volume per hectoliter (hl) of beer; for still wines: EUR 0 per hl of wine; for sparkling wines: EUR 35 per hl; for non-sparking fermented beverages: EUR 0 per hl, for sparkling fermented beverages: EUR 35 per hl, for intermediate alcoholic beverages: EUR 100 per hl; and for ethyl alcohol: EUR 650 per hl of pure alcohol. Ethyl alcohol is excise exempted if used as a raw material for the production of fermented products, vinegar, chocolate food products in which the alcohol content in is less than 8.5 liters per 100 kilos of chocolate, or for other food items less than 5 liters of alcohol per 100 kilos of goods; and for manufacturing of chemical and cosmetic goods. Completely denatured ethyl alcohol is also exempted from excises. Small producers of alcoholic beverages pay excises for produced quantities sold of alcoholic beverages over the quantities exempted for own consumption. A detailed regulation in this respect is envisaged by the Ministry of Finance.

Tobacco products subject to excise duties are: cigarettes, cigars and cigarillos, fine cut smoking tobacco, and other smoking tobacco. Cigarettes have a specific excise tax, determined as an amount for 1000 pieces, and an ad-valorem excise tax determined as a percentage of the retail price of what the tax administration determines to be the "most popular price category" of cigarettes. The minimum amount of excise tax that cigarettes must have is 110% of the total amount of excise tax (specific and ad valorem) determined for the "most popular price category" of cigarettes. In 2013 the specific excise tax is EUR 15 per 1000 cigarettes. The ad valorem excise rate is 36% of the "most popular price category" of cigarettes. The "most popular price category" of cigarettes was EUR 1.20 per pack of 20 cigarettes in 2013. This means that the minimum excise tax charge (specific and ad valorem) in Montenegro is EUR 0.80 per pack of 20 cigarettes (or EUR 40 per 1000 cigarettes). The retail price of cigarettes is determined by the producer by adding to the price without taxes the amounts of the excise tax (specific and ad valorem) and calculating the VAT for the product with the excise taxes. Excise duties for cigars and cigarillos are EUR 25 per kilogram; for fine-cut tobacco EUR 40 per kg and for other smoking tobacco EUR 25 per kg.

Tobacco products and alcoholic beverages, with the exception of beer and still wine, must be marked with excise control stamps by the producer or importer. Exports and sales of those products in duty free shops must also exhibit special stamps.

Mineral oils, their derivatives and substitutes are also subject to excise duties. For the purposes of the Law on Excise Tax, mineral oils include any product sold or used as engine fuel, additives or extenders added to engine fuels and any hydrocarbon produced from crude oil and which is sold or used as heating fuel except for coal, lignite, peat or biomass. The table below shows the excise duties charged for the different categories of mineral oils:

Type of mineral oil	Unit	Excise amounts per unit in EUR
Leaded petrol	1,000 litres	464.00
Unleaded petrol	1,000 litres	459.00
Kerosene used:		
- as motor fuel	1,000 litres	156.00
- for heating	1,000 litres	89.70
Gas oils used:		
- as motor fuel;	1,000 litres	350.00
- as motor fuel for industrial and commercial purposes;	1,000 litres	169.00
- for heating	1,000 litres	117.00
Fuel oil	1,000 kilograms	19.50
Liquid petroleum gas used:		
- as motor fuel;	1,000 kilograms	123.50
- as motor fuel for industrial and commercial purposes;	1,000 kilograms	58.50
- for heating	1,000 kilograms	26.00

Montenegro requires the marking of mineral oils that are used as heating fuel. Marking of mineral oils can only be carried out in the excise warehouses authorised by the tax authority.

There are no excises on electricity, natural gas or bituminous coal.

Montenegro stated that it levies excise duties on *coffee*. The products included are green and roasted coffee, coffee extracts, essences and concentrates, and other coffee based products. The excise duty is calculated as 20% of the value at import of the product including the amounts for customs duties and other import duties.

Carbonated water is also subject to excise duty payment. The products included are carbonated water with added sugar or other sweeteners or aromatisation agents. The excise tax is EUR 10.00 per hectolitre of carbonated water.

Montenegro stated that it will further align: the rate and the manner of determining the minimum excise duty on cigarettes with Council Directive 2011/64/EU; the scope of products subject to taxation (coal and coke, natural gas, and electricity) with Council Directive 2003/96/EC; and with the Excise Movement and Control System established in Council Directive 2008/118/EC. Montenegro stated that some legislative proposals to further align with the *acquis* on excises are already prepared by the Ministry of Finance.

II.b. Direct Taxation

Under the Law on Personal Income Tax, Montenegro applies a personal income tax on both residents and non-residents. The object of taxation of a resident natural person is the income generated inside and outside Montenegro. The object of taxation of a non-resident natural person is the annual income of any kind with a source in Montenegro, e.g. royalties, interest, capital gains and rental income.

Montenegro applies a flat tax rate of 9% for all income; except for the income from interests earned by a non-resident natural person (tax rate is 5%). For 2013 a temporary measure applies for wages and other personal employment income higher than EUR 720 monthly: the part over EUR 720 monthly is taxed at 15%. For income generated from property and property rights (e.g. rental income), the standard expenditures deducted are 30% of the gross proceeds. The payers of interest income, royalties and dividends, when the receiver is a natural person, resident or non-

resident, are obliged to withhold tax at the standard rate of 9%; except for the interest income paid to a non-resident natural person that has a withholding tax rate of 5%.

Montenegro stated that, as regards corporate profit tax, the tax rate is fixed at the standard rate of 9% for all types of business, public or private. Certain entities are exempted from profit taxation, such as: State authorities, local government authorities, public institutions, tourism organisations, sports clubs, sports associations and federations, religious communities, art associations, political parties, chambers, and trade unions. Non-governmental organisations do not pay profit tax if they are established under a special law to carry out a non-profit activity.

Profit is calculated in accordance with the accounting legislation and international standards. Certain revenues are exempted of income to avoid double taxation. This is the case for revenues from dividends and profit shares of other legal entities. Such revenues are exempt from the tax base of the recipient if the payer is subject to corporate profit tax under the Tax Law. The 9% withholding tax deducted by the payer is considered as final and clears the tax liability.

Montenegro declares that residents and non-residents have the same treatment in the determination of tax bases and tax rates.

The payer of interest, dividends, royalties, and other intellectual property rights compensations is obliged to withhold 9% of profit tax on the payments made to a non-resident legal entity. The payer of dividends and profit shares is obliged to withhold 9% of profit tax on the payments made to residents. There is no withholding tax on payments of interest, royalties, capital gains, rental of movable and immovable property, consulting services, market research and audit services when the receiver is a resident legal entity.

To avoid double taxation, a resident tax payer, who generates income outside of Montenegro and pays income tax in another country, gets a tax credit in the amount equal to the income tax paid in that country. The tax credit cannot exceed the amount of corporate profit tax that is attributable to the income generated outside of Montenegro through implementation of provisions of the Montenegrin income tax law for income generated in Montenegro (9%). Conventions on avoidance of double taxation supersede the provisions of the domestic law. Montenegro has double taxation agreements in force with 39 countries, including 21 out of 28 Member States. There are no double taxation agreements with Austria, Estonia, Greece, Luxembourg, Lithuania, Portugal and Spain.

Regarding asset transfers, Montenegro's legislation⁷ provides deferral of taxation for status changes such as mergers, divisions or partial divisions. The transfer of assets in case of status changes such as those foreseen in the Merger Directive (Council Directive 2009/133/EC) and the distribution of the share capital is not considered a sale of property. Thus, the transfer of assets in the event of status changes is not subject to profit tax. The right to defer payment of the profit tax on capital gains is allowed when the owner of the legal entity which transferred the assets receives compensation in the form of shares, even if there is a partial cash settlement which does not exceed 10% of the par value of the acquired shares. The tax liability for capital gains arises at the time when a legal entity, created by the status change, sells the assets taken over by the status change. The transfer of operating losses is exempt from taxation in the case of status changes. In the case when the assets of a subsidiary are transferred to the parent company, the parent company is not obliged to determine capital gain or loss.

⁷ Law on Companies and Business Organizations: Official Gazette of the Republic of Montenegro 06/02 and Official Gazette of Montenegro 17/07, 80/08, 40/10, 36/11; and Law on Corporate Profit Tax: Official Gazette of the Republic of Montenegro 65/01 and 80/04, and Official Gazette of Montenegro 40/08, 86/09, 14/12.

Regarding the Parent-Subsidiary Directive (Council Directive 90/435/EEC), Montenegro's Law on companies defines parent company and subsidiary, while the tax law does not define either parent company or subsidiary, nor the terms dividends or profit shares. Dividends are defined in agreements for the avoidance of double taxation.

A withholding tax of 9% is applied on dividend or profit shares payments to resident and non-resident legal entities and natural persons. A parent company resident in Montenegro obtains a tax credit for the amount of tax paid by its non-resident subsidiary in another country on dividends included in the revenue of the parent company. The tax credit is calculated as the amount that would have been paid under the Montenegrin tax law for those profits.

Regarding the consolidating of companies for tax purposes, the Montenegrin legislation considers that companies are related when the parent company has direct or indirect control of at least 75% of the shares or participation in the subsidiary company. The related companies, if resident in Montenegro, have the right to consolidate. Each company presents its tax return, and the parent presents as well the consolidated accounts.

In the area of transfer pricing Article 38 of the Law on Corporate Profit Tax contains Montenegro's main transfer pricing rules. The arm's length principle is only partly defined therein. Under article 38(6) the Ministry of Finance may prescribe more detailed regulations to clarify the transfer pricing rules, but this has not been done yet.

Regarding harmful tax competition, Montenegro declared that all legal entities, resident and non-resident, are subject to the same method of calculating the tax base and have the same tax rates. Montenegro stated that it fully accepts the principles of the EU Code of Conduct for Business Taxation, and that it will align its tax legislation and practices with the *acquis* in the area of the EU Code of Conduct for Business Taxation before accession.

Montenegro maintains certain tax exemptions or tax breaks such as:

- Legal persons or businesses newly established in an underdeveloped municipality conducting a production activity (except for primary production of agricultural products, transport, shipbuilding, fisheries or steel) are exempted from paying profit tax for the first eight years.
- Relief for NGOs: the tax base of an NGO registered to carry out economic activities shall be reduced by EUR 4,000 provided that it uses the profits for realisation of objectives for which it has been established.

Montenegro does not apply any **capital duties**, or any similar taxes on the raising of capital.

II.c. Administrative co-operation and mutual assistance

Montenegro's tax system and administration are limited by certain banking secrecy provisions. Data on account holders, account numbers and transactions, are considered banking secrets and cannot be made available by the bank, except to the Central Bank and to the competent judicial authority. Nevertheless, a certain degree of exchange of information is foreseen in the relevant provisions on exchange of information in some double taxation agreements.

As regards the fight against fraud, the Tax Administration of Montenegro concluded an agreement on mutual cooperation with five other tax administrations of the region in order to exchange information and provide assistance related to the detection of VAT fraud and avoidance and prevention of money laundering.

Montenegro stated that its law on Tax Administration will be gradually harmonized with the Directive on savings, and that it will also improve the technical capacity of the tax authority to facilitate the efficient exchange of information. Montenegro also stated that it will harmonise its legislation with Council Directive 2008/118/EC related to the Excise Movement and Control System (EMCS) where the exchange of information among taxation authorities is a basic requirement of the system.

II.d. Operational capacity and computerisation

The administrative unit in charge of taxation IT systems in Montenegro's Tax Administration is the *Department for Information Technology in the Field of Tax System*. It currently has 22 employees, but a 20% increase in staffing is planned. The maintenance of certain projects is outsourced.

The Tax Administration has a network connecting all branch offices with the headquarters in Podgorica and provides the required Intranet environment for the operation of all the applications running in the MTA IT System. Additionally, Montenegro has a general registry of taxpayers and insurers, a tax registration portal for taxpayers and a tax database information system. Online declarations are currently only available for payslips.

Montenegro stated that its main problems are the lack of an IT strategy, the lack of quality reporting and the lack of integration between the two existing revenue systems of taxation and customs. Its plans for IT upgrading include the online submission for: VAT returns, corporate profit tax returns, and balance sheet and income statements.

III. ASSESSMENT OF THE DEGREE OF ALIGNMENT AND IMPLEMENTING CAPACITY

Montenegro's general structure of the tax system is similar to that of EU Member States. Tax legislation is overall at a satisfactory level of alignment with *acquis* on VAT, excises and direct taxation, while the alignment is less satisfactory in the areas of cooperation and mutual assistance and computerisation.

As regards *institutional and administrative capacity*, Montenegro's Tax Administration needs to have the appropriate systems, procedures and personnel in place in order to implement and enforce the *acquis* covered by this chapter so that the continuation of a homogeneous and harmonised approach towards the EU is ensured. This requires the development of policies, systems, procedures, technologies and instruments compatible with EU requirements and standards.

Significant efforts are needed for further alignment to close remaining gaps and ensure application and enforcement of the *acquis*.

III.a. Indirect Taxation

In the field of indirect tax legislation Montenegro is at a good level of alignment. **Value Added Tax** follows the main structure laid down in EU legislation. However, there are still some discrepancies which need to be addressed by the time of accession.

The concept of intra-EU transactions is not a part of the VAT system in Montenegro and needs to be introduced into its legislation. The VAT scope needs some adaptations. The definitions and rules applicable to VAT territory, 3rd territories and countries, taxable persons, taxable transactions, place of taxable transactions, chargeable events and chargeability of VAT need to be aligned with the *acquis*. The VAT Law meets both conditions of the minimum standard rate

of 15% and a reduced rate of not less than 5% pursuant to the VAT Directive. VAT exemptions are mostly in line with *acquis*. However, some compulsory exemptions will have to be implemented and a few exemptions, which do not exist in the EU VAT legislation, will have to be abolished, for instance the import of certain goods for disabled people and the supply of medicines and medical devices financed by the RHIF. Certain goods and services subject to a reduced VAT rate are not aligned with the *acquis*, such as computer equipment and the services supplied in marinas. Montenegro will have to eliminate the reduced rate for those goods and services by the time of accession. It will also have to clarify the coverage of some goods and services subject to reduced rates such as teaching aids and copyrights.

Montenegro needs to clearly determine the definitions of newly constructed buildings, used passenger vehicles and the method of determination of the value of land separate from the value of the building constructed on it in order to align with accepted definitions and prevent loopholes that allow tax avoidance. The definitions of services, as for example the international transport of passengers, need to be aligned with the *acquis* in order to properly identify if operations with non-residents are B2B or B2C transactions. The same applies for engineering and advertising.

Montenegro has to align with the *acquis* on the special schemes (e.g. for second-hand goods and travel agencies). It has to implement the special scheme on investment gold and needs to further detail the rules for VAT refunds to taxable persons not established in Montenegro. In particular, Directive 2008/9/EC will have to be transposed. The threshold of EUR 18,000 for SMEs is in line with the derogations granted to the new Member States (Article 287 of the VAT Directive). The special taxation procedures for farmers and travel agents are aligned with the *acquis*.

Formal obligations will have to be aligned, in particular those on: signature of invoices (signature not required in *acquis*), electronic invoicing (no need to request authorisation to invoice electronically), and recapitulative statements for intra-EU transactions.

In the field of **excise duties**, Montenegro follows the main structure of EU legislation, but there are some differences in the products covered. It has excise duties on coffee and carbonated water which are not included in the *acquis*. The EU applies excises on bituminous coal, electricity and natural gas which do not exist under Montenegro's tax legislation.

With regard to travellers' allowances for persons travelling from third countries, Montenegro will need to adapt the allowances for alcohol⁸. Montenegro's legislation is in line with the *acquis* on tobacco travellers' allowances but it will have to adapt the allowances for perfumes and eau de toilette, as in the *acquis* there are no specific limits for those two product categories. In the *acquis* those products are included under the travellers' allowance generic monetary limit for imported products that should not be higher than EUR 430 for air and sea travellers and EUR 300 for other travellers. These limits need to be reviewed as well in Montenegro as their limit is just EUR 150.

Montenegro will have to introduce the EU Excise Movement and Control System (EMCS).

Montenegro's legislation is in line with the minimum levels of rates of excise duties on *alcoholic beverages* set in the *acquis* (Council Directive 92/84/EEC). It will have to align its legislation and practices in relation to the taxation of "small producers" and "personal uses"⁹.

⁸ EU legislation allows for a traveller to bring in either: (a) 1 litre of alcohol exceeding 22% of alcohol by volume (abv) or (b) 2 litres of alcohol not exceeding 22% (abv). Travellers may also bring in 4 litres of still wine and 16 litres of beer.

⁹ Montenegro's Excise Law exempts the alcohol produced by small producers for their own consumption which appears not to be in line with the 50% minimum taxation threshold of Council Directive 92/83/EEC.

On *tobacco products*, Montenegro needs to align with Council Directive 2011/64/EU on the provisions on the length of cigarettes. The cigarette excise tax in Montenegro has a specific excise tax component, determined as an amount per 1.000 pieces, and an ad valorem excise tax, determined as a percentage of the retail price of the category of cigarettes with the most popular price. The most popular price category (MPPC) is determined by the tax administration and the process of how it is determined is not in line with the EU's weighted average retail selling price (WAP) used for the ad valorem excise component. Regarding the minimum taxation of cigarettes, Montenegro's excise legislation requires that excise taxation be at least 110% of the total excise (specific and ad valorem) of the MPCC, while the *acquis* establishes that it must be at least 57% of the WAP (60% as of 1 January 2014) and shall not be less than EUR 64 per 1000 cigarettes of the WAP (EUR 90 as of 1 January 2014). This difference in the minimum taxation of cigarettes allows a different level of taxation in Montenegro that must be aligned to the *acquis*.

The *acquis* on minimum taxation in the other three categories of tobacco products establishes the minimum excises at the following levels: for fine cut tobacco, 43% of the WAP or at least EUR 47 per kilogram; for cigars and cigarillos, 5% of the retail selling price inclusive of all taxes or at least EUR 12 per 1000 items or per kg; and for other smoking tobacco, 20% of the retail selling price inclusive of all taxes or at least EUR 22 per kg. Montenegro nearly fully complies with those requirements as their excises for those three categories are respectively EUR 40, EUR 25 and EUR 25 per kg.

As regards *energy products*, the range of products subject to excise payments in Montenegro is currently smaller than what is required by the Energy Taxation Directive¹⁰. The following table shows the differences with the *acquis* in excise taxation in energy:

Excise taxation on fuels and electricity	Unit	Montenegro excise amounts per unit in EUR	EU minimum excise amounts per unit ¹¹ in EUR
Leaded petrol	1,000 litres	464.00	421.00
Unleaded petrol	1,000 litres	459.00	359.00
Kerosene used:			
- as motor fuel	1,000 litres	156.00	330.00
- as motor fuel for industrial and commercial purposes;	1,000 litres		21.00
- for heating	1,000 litres	89.70	0.00
Gas oils used:			
- as motor fuel;	1,000 litres	350.00	330.00
- as motor fuel for industrial and commercial purposes;	1,000 litres	169.00	21.00
- for heating	1,000 litres	117.00	21.00
Fuel oil	1,000 kg	19.50	15.00
Liquid petroleum gas used:			
- as motor fuel;	1,000 kg	123.50	125.00 ¹²
- as motor fuel for industrial and commercial purposes;	1,000 kg	58.50	41.00
- for heating	1,000 kg	26.00	15.00

¹⁰ Council Directive 2003/96/EC.

¹¹ Directive 2003/96/EC, Annex I, Table A, Table B and Table C.

¹² However the Directive allows Member States to apply a tax reduction/exemption to LPG used as motor fuel, but subject to a formal notification and approval by the European Commission.

Excise taxation on fuels and electricity	Unit	Montenegro excise amounts per unit in EUR	EU minimum excise amounts per unit ¹¹ in EUR
Natural gas			
- as motor fuel;	Gigajoule		2,60
- as motor fuel for industrial and commercial purposes;	Gigajoule		0,30
- for heating: business use	Gigajoule		0,15
- for heating: non-business use	Gigajoule		0,30
Coal and coke			
- for heating: business use	Gigajoule		0,15
- for heating: non-business use	Gigajoule		0,30
Electricity			
- for heating: business use	MegaWatt/h		0.50
- for heating: non-business use	MegaWatt/h		1.00

The following products would in principle have to be made subject to excise payment of at least the EU minimum rates: kerosene as motor fuel, liquid petroleum gas as motor fuel, natural gas, coal and coke, and electricity. Changes required have been marked in bold in the table above.

The system used by Montenegro for fiscal fuel markers in gas oils and kerosene is not aligned with the *acquis*¹³. Montenegro is only marking mineral oils used as heating fuel which leaves out some tax-exempt uses, e.g. those of gas oil used in commercial navigation or cases where a lower rate of taxation is applied, e.g. gas oil for industrial and commercial purposes¹⁴.

For all three categories of excisable products – alcohol, tobacco and energy - Montenegro also needs to adopt the EU's system of warehousing and duty suspension, and ensure compliance with the duty-points (times for charging duty) that are required by that system.

Regarding coffee excises, the taxation measures need to be thoroughly reviewed in order to give a similar treatment to local and to imported products, and to prevent that the excise duty acts as an additional customs duty, protecting domestic added value.

III.b. Direct Taxation

Montenegro has a satisfactory level of alignment with the *acquis* on direct tax legislation.

Regarding the Savings Directive (2003/48/EC), Montenegro needs to be prepared to exchange information on interest payments to individuals with all the Member States and with the 12 dependent or associated territories of the Netherlands and the United Kingdom that have requested reciprocity. In addition, during the transitional period foreseen by the Directive, Montenegro will have to ensure the elimination of any double taxation which might result from the imposition of the withholding tax levied on interest payments under article 11 of the Directive. The same measures to ensure the elimination of double taxation will have to be implemented in the context of the bilateral savings agreements with the EU dependent and associated territories. In relation to the withholding tax under the EU savings agreements with Switzerland, Liechtenstein, Andorra, Monaco and San Marino, Montenegro will have to ensure the elimination of any double taxation due to that tax too.

¹³ Directive 95/60/EC provides for a common marking system.

¹⁴ Still Directive 95/60/EC allows Member States not to apply the marker on grounds of public health or safety or for other technical reasons. However in such cases Member States must take appropriate fiscal supervision measures.

In this context, prior to accession Montenegro will also have to:

- include in its legislation the definitions of: "interest payment", "paying agent" and "beneficial owner"
- implement the operational provisions on the determination of the identity and residence of beneficial owners with reference to contractual relations or transactions dating as far back as 1 January 2004 onwards. Montenegro will have to review the data gathered from non-residents, in order to include the information in the prescribed level of detail and implement its subsequent automatic exchange;
- notify its "competent authority" to the Commission;
- examine if the Annex to the Savings Directive has to be completed as far as Montenegro entities are concerned;
- conclude bilateral agreements for the same measures as those of the Directive with the 12 dependent or associated territories of the Netherlands and the United Kingdom, in accordance with the models agreed by Member States for this purpose;
- confirm to Switzerland, Liechtenstein, Andorra, Monaco and San Marino the political commitments taken by Member States within the Memorandums of Understanding accompanying the EU agreements on taxation of savings with these non-EU European countries;
- apply the provisions of Article 15 of the Agreement on taxation of savings between the EU and Switzerland as far as dividends, interest and royalties payments between associated companies are concerned;
- communicate to the Council the application of the Agreements with Switzerland, Liechtenstein, Monaco, Andorra and San Marino¹⁵.

Substantial changes will have to be made to the secrecy provisions in the tax and banking laws to enable the collection and exchange of information on an automatic basis.

As regards corporate tax, Montenegro's system follows the same general lines as the EU legislation. However, Montenegro needs to ensure alignment with the Parent Subsidiary Directive (Council Directive 2011/96/EU) on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. The elimination of double taxation will have to be guaranteed by the adoption of provisions offering tax credits or exemptions to resident companies receiving dividends from other Member States which have already supported a tax burden. Regarding dividends distributed by Montenegro resident companies, a system of direct exemption must be adopted.

Alignment needs to be ensured with the Merger Directive (Council Directive 2009/133/EC) on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States as well as to the transfer of the registered office, of a *Societas Europaea* (SE) or European Cooperative Society (SCE), between Member States. For this purpose, Montenegro will have to:

- Extend the deferral tax regime to transfer of assets where the shares issued in consideration by the receiving company are acquired by the transferring company;
- Cover the case of exchange of shares, since the deferral of taxation is also linked with other rules concerning the valuation of shares exchanged that have to be ruled;
- Cover triangular cases, where the merger, division or transfer of assets include a permanent establishment situated in a Member State different from that of the transferring company;

¹⁵ And also with Saint Barthelemy, when the EU agreement on taxation of savings with this territory enters into force.

- Rule the case of the transfer of seat of a SE or and SCE in both cases, where the company leaves Montenegro or moves to Montenegro. Even if there is no taxation on these cases, there are rules concerning the valuation of the assets that are relevant for future taxation.
- Provide for the exemption of capital gains deriving from the cancellation of the holding that the receiving company may have in the transferring company that is dissolved in the occasion of a merger or a division.

Upon accession at the latest, Montenegro also needs to transpose the Interest and Royalties Directive (Council Directive 2003/49/EC).

Montenegro needs to further legislate in the area of transfer pricing so that its national legal framework is consistent with the arm's length principle and the *acquis* in this area, so that legal certainty is ensured.

As regards the EU *Code of Conduct for Business Taxation*, Montenegro's commitment to withdraw and to abstain from introducing potentially harmful tax measures will be monitored. An assessment as to whether Montenegro's current tax provisions fully comply with the principles and criteria of the Code of Conduct requires a further in-depth analysis. In addition, Montenegro's direct tax system and, in particular its tax exemptions and tax breaks, need to be brought in line with the *acquis* on State aid (*see Competition chapter*).

III.c. Administrative co-operation and mutual assistance

Montenegro's legislation is not aligned with the *acquis*. Montenegro does not have any specific provisions reflecting the *acquis* on administrative cooperation and mutual assistance.

The tax cooperation in the EU requires effective exchange of information and mutual assistance between the Member States' tax authorities. Administrative structures such as the Central Liaison Office and the Excise Liaison Office must be created to process the information, allow the cooperation and channel the assistance requests.

The present legal framework restricts the exchange of information. Banking secrecy is in force and Montenegro's Tax Administration cannot obtain data concerning savings interest and provide it to the EU Member States. To enable effective administrative cooperation, substantial changes will have to be made to the secrecy provisions in the tax and banking laws.

With regard to the Administrative Cooperation Directive (2011/16/EU), Montenegro needs to be prepared to fulfil all requirements included, in particular with regard to exchange of information on request, spontaneous and mandatory automatic exchange of information with all the Member States from the date of accession.

Montenegro does not offer recovery assistance to other countries and no plans have been foreseen to this end. Montenegro needs to adopt the necessary legislative and administrative measures and establish the appropriate infrastructure to be ready to apply the recovery directive (Council Directive 2010/24/EU) upon accession.

III.d. Operational capacity and computerisation

Montenegro is still at an early stage of alignment with the *acquis* and needs to make substantial efforts to endow its tax administration with the appropriate IT systems, procedures and personnel in order to implement and enforce the *acquis*.

Montenegro needs to develop its strategy for the improvement of its IT capacity and performance, and to create the conditions for interoperability and interconnectivity of its IT systems to allow the exchange of computerised data with the EU Member States.

As regards *computerisation* in the field of VAT, Montenegro will need to adapt its IT systems to allow interoperability and interconnectivity with the EU systems (VIIES). Montenegro also needs to ensure that the exchange of information among Member States related to the special scheme for e-Services provided by non-EU traders to EU citizens is in place and inter-connected with EU systems, as well as for refund of VAT as envisaged in Council Directive 2008/9/EC.

Regarding excise duties, Montenegro needs to put in place a national system of surveillance for the movements of excisable products, and develop an infrastructure that allows physical interoperability and interconnectivity with the EU EMCS and its supporting systems: the SEED register of operators and the CS/MISE system for monitoring. In developing the EMCS a timely alignment with the *acquis* (Council Directive 2008/118/EC) concerning the general arrangements for excise duty needs to be taken into account.

In the area of direct taxation, Montenegro needs to adapt its IT system to allow the exchange of information foreseen under the EU law on the date of accession, as well as to ensure the correct application of the company tax and administrative cooperation directives.

Montenegro will also need to prepare for the exchange of all other forms in the taxation domain. For example, the Montenegrin taxation information needs to be integrated in the "Taxes in Europe" database available on the Europa website.

Finally, Montenegro's overall performance in both areas, taxation and customs, would also improve if its IT Customs and IT Taxation systems were mutually integrated.