



Regulation of natural loss, surplus, damage, spoilage, and destruction of products for tax purposes

Pristina, Kosovo

April 2024

I. INTRODUCTION

During the discussions in the sectoral forums organized by the Secretariat of the National Council for Economy and Investments in March 2024, the issue of (non)recognition of natural losses, surpluses, damage, destruction, and spoilage of products for the tax purposes was raised. Considering that these issues are closely related to the Kosovo Custom (KC) for the part of border taxes and to the Tax Administration of Kosovo (TAK) for income taxes, to address this issue actions must be taken by the Ministry of Finance, Labour and Transfers (MFPT) which is responsible for these two institutions as well.

As for KC, the challenge of the private sector has to do with the non-existence of standard loss rates according to products, as they are defined in some of the countries of the region and the EU. These standards would serve to reduce the value of the excise tax, and, consequently, the VAT at the border, in cases where the products lose their quantity during transportation, storage and production. From the analysis of the legal regulation of this issue, we noted that the draft new Customs Code, as in some of the countries of the region and the EU, foresees the determination of these standard rates of loss in the quantity of products that are subject to excise tax. The draft code foresees that these standard rates will be determined by a by-law by the Ministry of Finance, Labor and Transfers (MFLT).

On the other hand, the private sector has also expressed complaints about the process of recognition of natural losses, surpluses, damages, deterioration, and destruction of products for income tax purposes by TAK. Although the issue of damage, spoilage and destruction of products is regulated to some extent by the tax legislation in force, businesses have expressed more concern regarding the complicated procedures for their documentation. Moreover, there are no standard rates to determine natural losses or other aspects such as surplus that would simplify this process.

Given the issues raised by the private sector, the purpose of this report is to provide information on the current regulation of losses of product, to analyse international practices, as well as to provide an analysis of the possible implications for businesses when facing procedures that make it difficult to recognize these losses.

This report is organized as follows. In the second part, an analysis is presented on the laws and by-laws which examine the issues mentioned above. The third part focuses on the regulation of these issues in some of the countries of the European Union and the region. In the fourth part, the impact of non-recognition of the losses of some products on businesses is presented. While in the last part, we provide several recommendations.

II. CURRENT REGULATION

The initiators of this issue have requested that the relevant law or by-law be issued regulating the recognition of real product losses.

They consider that through legislation, clear alternatives for recognizing losses during work processes for certain industries (deterioration, loss, evaporation, weight loss) can be set.

Meanwhile, they have explained that in certain industries, loss in the amount of products is inevitable due to regular work processes.

A real problem, as the companies have expressed, is the fact that the current procedure provided by law takes several days from the initiation by the taxpayer. This presents an issue as it is necessary to store quantities of plastering products for whole days. They have proposed to establish standard rates for the food industry, which would be uniformly applied to identify product loss.

Tax legislation

Law on the Administration of Tax Procedures

Law No. 08/L-257 on the Administration of Tax Procedures, recently approved, as an act that regulates the administration of tax procedures, foresees the issue of loss of products in paragraph 13 of its article 15. According to this provision, for the correct determination of the taxpayer's tax

obligations, the latter must document the lack of goods with reliable facts issued by the competent authorities. In the absence of this documentation, such goods will be considered sold for tax liability purposes.

The fact that undocumented goods are counted as sold for income tax purposes reflects reality. However, in practice, as the companies have stated, even in cases where the loss is documented, but the products are not measurable by units (pieces), TAK does not recognize them as deductible expenses.

While the sub-legal act which determines the implementation of this law must be issued within this year, the administrative instruction for the implementation of Law No. 03/L-222 on Tax Administration and Procedures, which has already been repealed, regulates this issue with articles 24 and 25.

According to Article 24 of this AI, when a taxpayer calculates his income on a real basis, destroys a part of the stock for various reasons, such destruction can be considered as an expense of economic activity. In order for this to be recognized by TAK, the taxpayer must provide acceptable documentation, otherwise, the goods are considered sold and taxed in accordance with those rules.

On the other hand, Article 25 of this AI provides that the part of goods destroyed or damaged by disaster or loss due to theft can be accepted as a deductible expense for tax purposes, as long as specific conditions are

met. Even in this case, the taxpayer must provide evidence of the loss of the goods.

Personal Income Tax Law and Corporate Income Tax Law

This issue is also regulated through Law No. 05/L-028 on Personal Income Tax, as well as Law No. 06/L-105 on Corporate Income Tax. The issue of loss is provided for in article 30, paragraph 1.9, and article 9, paragraph 1.9, in each law respectively. Both of these acts provide that during the determination of taxable income, no deduction is allowed beyond the rates determined by special legal and by-law acts for those losses, damages, waste, excess, destruction or breakage during production, transportation, storage and exposure.

In other words, it is required that through a by-law, the maximum rates for the lost mass of products in all stages until their sale are determined. Such a by-law has not yet been issued, leaving this issue unsettled.

In explanation of this provision, Administrative Instruction No. 01/2016, for the implementation of the Law on PIT, undocumented expenses, as well as those that do not meet the criteria provided by the relevant law, are considered inadmissible expenses.

Value Added Tax Law

Another important element for the matter in question is the moment when VAT becomes chargeable to the taxpayer.

As a principle, Law No. 05/L-037 on Value Added Tax specifies in its article 22 that the moment when the obligation arises and when VAT becomes chargeable is the moment of supply of goods and services.

Whereas, according to Article 23, paragraph 2.3 of this law, when the goods are imported, the tax obligation arises on the day on which the customs obligation also arises. For goods that are not subject to customs duties, VAT becomes chargeable on the day when the customs duty would arise according to the legal provisions on customs duties.

Customs legislation

Code No. 03/L-109 Customs and Excise

Article 203, paragraph (c) of the current Customs and Excise Code of Kosovo clarifies that, among other things, no customs obligation arises in the event that: "the use of the customs procedure under which the goods have been placed, results from the complete disposal or the irreversible loss of these goods, due to the very nature of the goods or unforeseen circumstances or force majeure, or as a result of authorization issued by Customs". In simplified terms, this means that an economic entity will not be forced to pay customs duties in case that product has been irretrievably lost, i.e. it has become unusable.

Regulation according to Project Code No. 08/L-247 Customs and Excise

The draft Customs and Excise Code has already been approved in the second reading by the Assembly. This act deals with the issue of product loss in much more details.

First, in its article 88, this act foresees the cases in which the customs duty on import or export is extinguished.

One of these cases, foreseen by paragraph 1.7 of this article, is the situation when the disappearance or loss of goods, or non-fulfillment of obligations under customs legislation, result from the total destruction or irreversible loss of these goods. This can be reached as a result of the nature of the goods themselves, unforeseeable circumstances of a force majeure, or according to the instructions of the Customs. For purposes of definition, this provision stipulates that losses are considered irreversible when the goods become unusable by any person.

Moreover, the issue of loss is also regulated by article 198 of this draft code, which determines the way of calculation and payment of the excise tax.

In principle, the obligation for the calculation and payment of the excise duty derives from the release of excise products into free circulation in Kosovo. However, as determined by paragraph 1.3 of this article, this customs obligation does not arise when a lack or loss is evident, either during

production or storage, or during movement in the excise duty suspension system.

Further, in the provisions of paragraph 2 of this article, the cases which do not constitute release for consumption of goods are discussed. This includes, firstly, the cases when the loss or destruction (not even theft) is attributable to unforeseen circumstances or force majeure or was committed as a result of the destruction of excise goods under customs supervision. Secondly, the goods are not considered to have been released for consumption when the lack or loss is inextricably linked to the characteristics of the products, and which arose during the production, storage, and movement of excise goods.

Similarly, even in these cases, the products are considered irretrievably destroyed/lost when they can no longer be used as excise goods.

As for the loss or lack of raw materials, or other excise products which were used for the production of products in the excise warehouse, the customs obligation for excise arises according to the norms of production with customs authorization.

In this aspect, the loss or lack is ascertained as the difference between the expected amount of production, the norms of the production process and the production loss coefficients, based on the authorization of the excise warehouse for the products declared as produced from these raw materials.

Finally, this article obliges the relevant Ministry of Finance to, through a by-law, determine the rules and procedures regarding the absence or loss of excise products in the system of suspension of excise duty payment during production, storage and movement, recording, inventory of losses or shortages in the evidence and accounting system. Taking this into account, the part of the partial loss, in accordance with the definition in paragraph 2 of this article, that exceeds the amount determined by this by-law will be considered as consumption. This is not applied in case of reasonable suspicion of fraud or irregularity.

This also represents a substantial change in relation to the current Code in force. According to the Code in force, regardless of the limits established with the standard rates of loss, in case the subject proves that the real loss has exceeded these rates, the latter are not applied.

With the entry into force of this act, it remains the responsibility of the Ministry of Finance, Labor and Transfers to issue the relevant sub-legal act, and to shed light on the applicable procedures related to this issue.

III. PRACTICES IN THE EUROPEAN UNION AND THE REGION

In the European Union, issues related to spoilage, evaporation and disappearance of products are mainly regulated through Regulation No. 952/2013 on the Customs Code, as well as Directives such as 2008/118/EC on General Rules on Excise.

¹ Article 124 of the Regulation on the Customs Code describes the conditions under which the customs duty may be extinguished, including cases where the products are irretrievably lost due to their nature, force majeure events and other processes. Furthermore, this regulation stipulates that the standard rates for foreseeable losses apply unless the business documents that the loss is higher. However, Directive 2008/118/EC allows Member States to set the conditions for proving losses, especially during transport or processing.

Depending on the EU member state, different rules are applied regarding the recognition of losses, especially those goods for which excise duty is applied. While most countries have fixed standard rates for loss in quantity during the transport of excise goods, some other countries, such as Denmark and Sweden, do not apply fixed rates. ² Members that apply fixed rates usually take into account different criteria related to the mode of transport and the duration of transport in determining the

¹ Regulation (EU) No. 952/2013 of the European Parliament and the Council

² Rates applied in some EU member states for losses due to the nature of excise goods during transport

levels of quantity losses. For example, in Bulgaria the standard rates allowed for natural loss of alcohol products are based on the way the product is stored. More specifically, if the product is being transported through the wood barrel, other norms are applied compared to other forms of storage such as the use of containers.

As far as the region is concerned, Albania has defined standard rates for losses in quantity for goods subject to excise duty. These standards are divided into several categories including standard rates for technical losses in transport and simple operations, natural losses, and losses during production and processing processes.³ Moreover, in Albania, the decision has been made that also recognizes the losses during the production process for fiscal purposes such as income tax.⁴ Based on this decision, for products that have excise duty, the standard rates that are already set are used. While for other products that are used as raw materials during the production process, rates are determined through technological cards that describe the process of production or processing. These technological cards must be certified by a recognized state institution that has the technical ability to confirm them.

As for the rest of the region, other countries also follow the practice of using standard rates for recognizing losses of final products,

in cases when they are used as raw materials or during other processes they go through.

IV. ECONOMIC IMPACT

The general impact on the economy

Quantifying the impact of product loss, damage, spoilage, and destruction on the economy in the absence of detailed data is quite challenging. This is due to the complex nature of certain products, the nature of industries, transport and storage practices, the characteristics of the legal regulation of these aspects and many other factors related to the supply chain. Despite this, from the study of practices in different countries, we notice that there are some economic activities which are more affected by the loss of a part of both final products and losses during the production process. These economic activities include, among others, production, processing, trade, cultivation of agricultural crops including livestock, water and energy supply, transport and gastronomy.

Figure 1 shows the structure of Gross Domestic Product (GDP) according to economic activities in 2023.⁵ Based on this figure, economic activities that are affected by the issue of losses on products represent about 55% of GDP in 2023. These activities include wholesale and retail trade,

³ Decision No. 612, dated 5.9.2012, on the implementing provisions of the excise law.

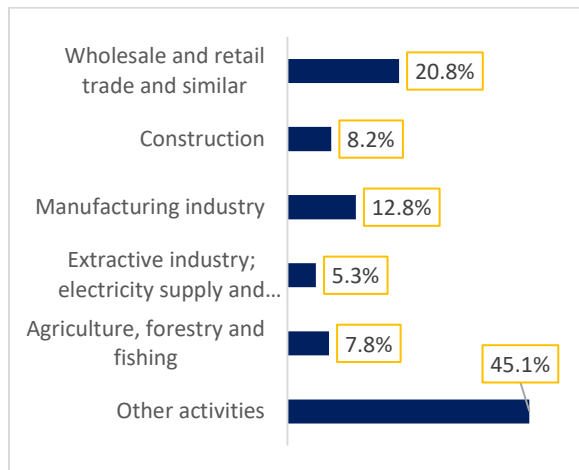
⁴ Decision No. 434, dated 20.5.2015, on determining the rates for losses, damages and wastes during

production, storage, transportation, etc., recognized for fiscal purposes

⁵ These figures are only estimates by the Kosovo Agency of Statistics; they are reviewed in September 2024.

processing industry, extractive industry, energy supply and agriculture. While other activities in the figure consist of economic activities that are not affected by product losses since they mainly represent services.

Figure 1. Structure of GDP according to economic activities



Data source: Kosovo Agency of Statistics (KAS)

Impact on businesses

Non-recognition of natural losses, damage, decay, etc. of products has an impact on increasing the cost of businesses. In addition to losing some of their stock, businesses end up paying taxes on products that never reach the market. Any additional cost limits businesses in raising their capacities through investments, which would also affect the increase of the labour force. While some businesses try to cover this additional cost by increasing prices for consumers, some businesses find other ways that increase informality and tax evasion by declaring fictitious sales as compensation for the creation of additional cost. The use of practices for tax avoidance negatively affects

honest businesses that respect tax regulations as they face an unfair competition. This in turn negatively affects the perception of these businesses for government institutions and the state in general.

Failure to recognize losses creates an unrealistic picture of businesses and the economy in general. Facing a situation where losses are not recognized by the tax authorities can lead to unrealistic financial reporting by businesses. This inaccurate reporting damages the integrity of the financial statements, causing a wrong perception not only of certain businesses but also of the industry in which the businesses operate. Financial statements are the main source of information for potential investors through which returns on investments are analysed.

Facing an additional cost reduces the competitiveness of businesses even in the international market. Facing this additional cost, from which competitive businesses from the region and the world are affected to a less degree, since their countries have regulated this issue in a more appropriate way, businesses in Kosovo are less competitive in the international market.

Failure to adequately regulate this issue has a negative impact on the perception of doing business in Kosovo by potential investors. Facing an additional tax payment due to the non-recognition of product losses discourages potential investors from investing in Kosovo, especially when in the

countries of the region - competitors for attracting foreign investors - this issue is regulated.

V. CONCLUDING REMARKS AND RECOMMENDATIONS

Proper regulation of the issue of recognition of product losses is an important step towards improving doing business in Kosovo. While for local businesses the lack of proper regulation represents an additional cost, for potential investors it can negatively affect their perception of doing business in Kosovo. Considering the impact of this issue it is important to take steps that adequately regulate it including:

- Issuance of the by-law for standard loss rates for excise products by the Ministry of Finance, Labor and Transfers. In addition to executive agencies such as TAK and Customs, it is important to include the Ministry of Industry, Enterprise and Trade (MIET) in determining these standard rates.
- Standardization and simplification of the procedures for recognition and documentation of damage, destruction, spoilage of products by MFLT and TAK through the new administrative instruction that is expected to be completed this year within the framework of the new law on the administration of tax procedures. In order to achieve this goal, the new by-law should also foresee the involvement of other

relevant institutions that have technical skills for documenting damage, destruction, breakdown and other failures of products.

- Consideration of the possibility of determining standard loss rates for other non-excise products for tax purposes, through the law on corporate income and the law on personal income.