



Improving the Business Environment in BiH

# **WHITE BOOK 2008**

*PRIORITY SOLUTIONS FOR OBSTACLES TO INVESTMENT AND GROWTH IN BOSNIA AND HERZEGOVINA*



# **WHITE BOOK 2008**

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## 1. FOREWORD

The White Book is a publication produced on an annual basis by the Foreign Investors Council (FIC). Its purpose is to provide BiH authorities with a prioritized agenda of reforms in order to address key obstacles to investment in Bosnia and Herzegovina (BiH) and to support BiH on its way to joining the European Union.

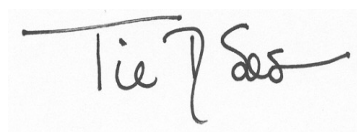
In today's rapidly changing world, it is essential to create a favourable business climate and to have government institutions that provide full support to both domestic and international investors. Unfortunately, BiH is, in many parts of the world, still considered a high risk investment area due to regional instability, but also due to unnecessary internal complications. Despite the complex situation, improvements are possible, but can only be accomplished by joint efforts at all levels of government.

During the current financial and economic turmoil, fluctuations in direct investments can be expected, but the sluggish pace of economic reform and the slow removal of obstacles to foreign investment will leave BiH behind the neighbouring countries which are much more pro-active.

We hope that the signing of the Stabilization and Association Agreement with the European Union will mark the beginning of a new era in Bosnia and Herzegovina and that government officials will accelerate reforms in order to ensure that the business environment is predictable and transparent.

By providing support and partnering with all levels of government to improve the business environment in the country, the FIC Membership will spare no effort in assisting BiH in moving forward economically. We welcome comments and look forward to productive collaboration over the coming years with all the stakeholders in BiH.

Last but not least, we would like to thank the numerous FIC Members for devoting their time and resources in the preparation and the development of the FIC White Book 2008.



Tie Sosnowski

FIC President and on behalf of FIC Board of Directors



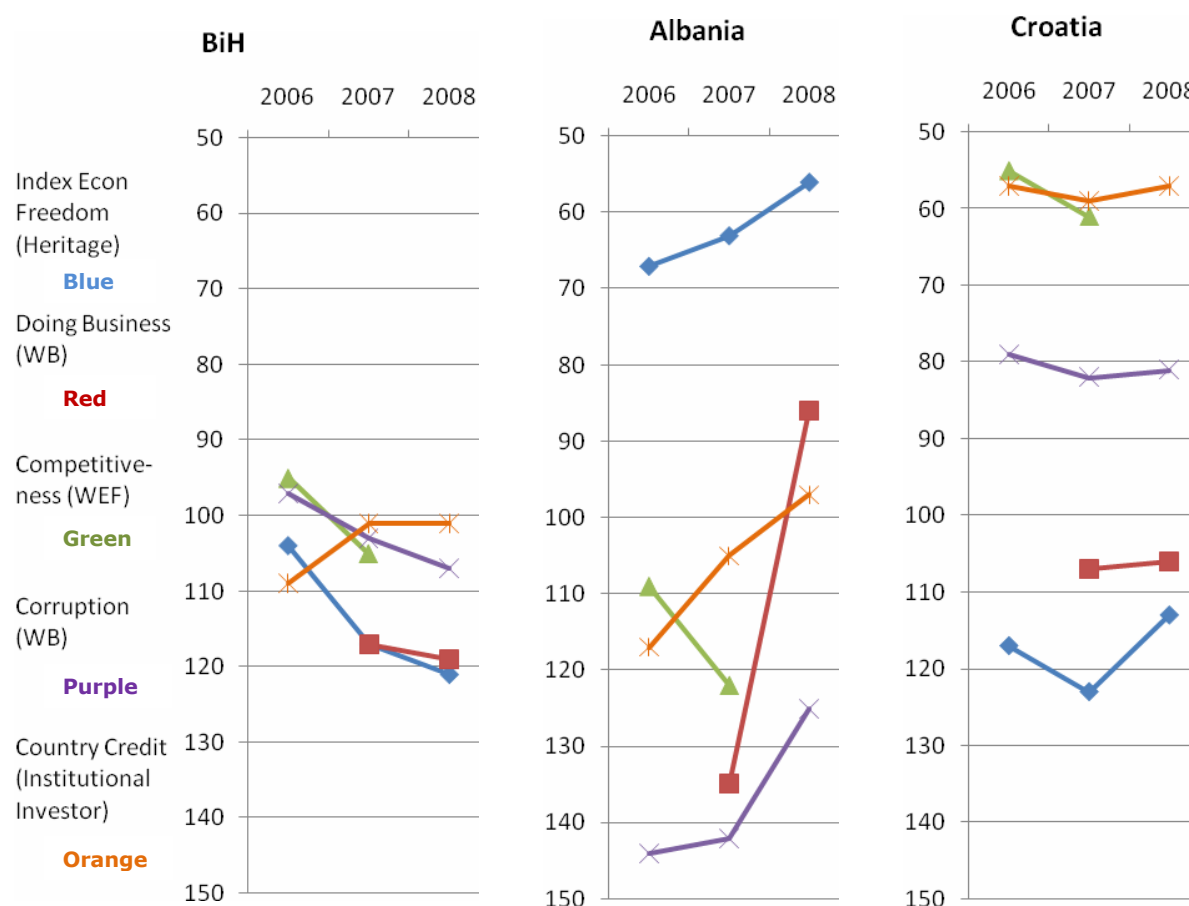


## 2. EXECUTIVE SUMMARY

Foreign investment is one of the most important drivers of economic growth for an “emerging economy” like Bosnia and Herzegovina. Foreign investment, amounting to as much as 10% of GDP in some years, has helped transform the economies of Poland, the Czech Republic, Slovakia, and Hungary – countries that the former Yugoslavia used to outpace in economic terms. Foreign investment both expedited their accession to the European Union and has also become a significant contributor to the growth of employment and incomes in these countries.

BiH is improving gradually as a target for foreign investment. We, the Foreign Investors Council, know this because we are the drivers of that investment. But this improvement is far too gradual. BiH is losing time by failing to dedicate itself to a radical liberalization of the business environment. As has been documented in various cross-country surveys of the business environment, BiH is actually slipping back, year-by-year, in most rankings relative to other countries. The following chart which compares BiH to two other countries from the region clearly demonstrates this.

Chart 1: Indicators of Investment Attractiveness



Source: World Bank – IFC Business Environment Snapshot<sup>1</sup>

<sup>1</sup> <http://rru.worldbank.org/BESnapshots>

Other than the country credit rating, all four of the other major gauges of the business environment show BiH falling in the rankings over the past three years. In contrast, Albania is improving sharply in most rankings from a low base, and now ranks much higher than BiH in the World Bank's Doing Business measurement. Croatia has remained at about the same level, but in all the measures it is currently ranked higher than BiH.

In our first White Book (White Paper 2007), we identified two key areas of the business environment that are ranked by the World Bank survey. These were starting a business and registering property – which is critical to the construction sector. We observed that in the 2006 survey, BiH ranked last among all the countries of Southeast Europe in both of these categories. Unfortunately, two years later, BiH has shown no improvement in the ranking in these two areas and in the most recent 2008 survey, it is again in last place.

Chart 2

**Business Startup**

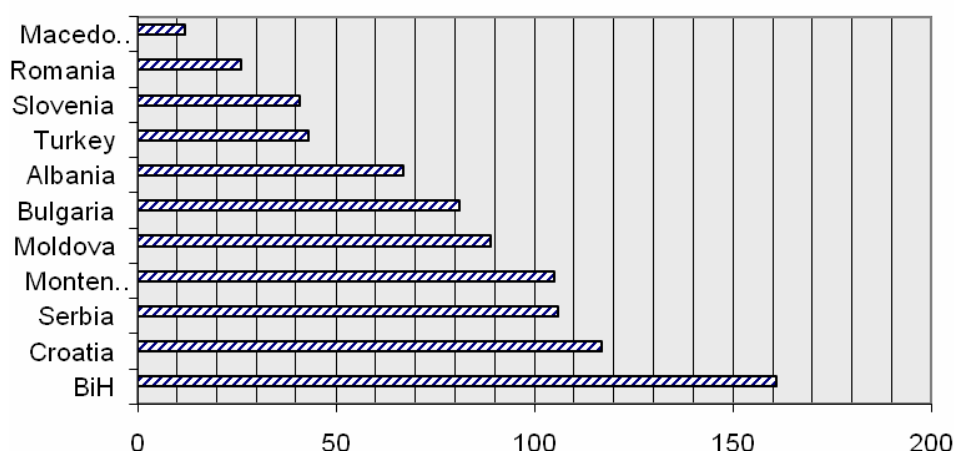
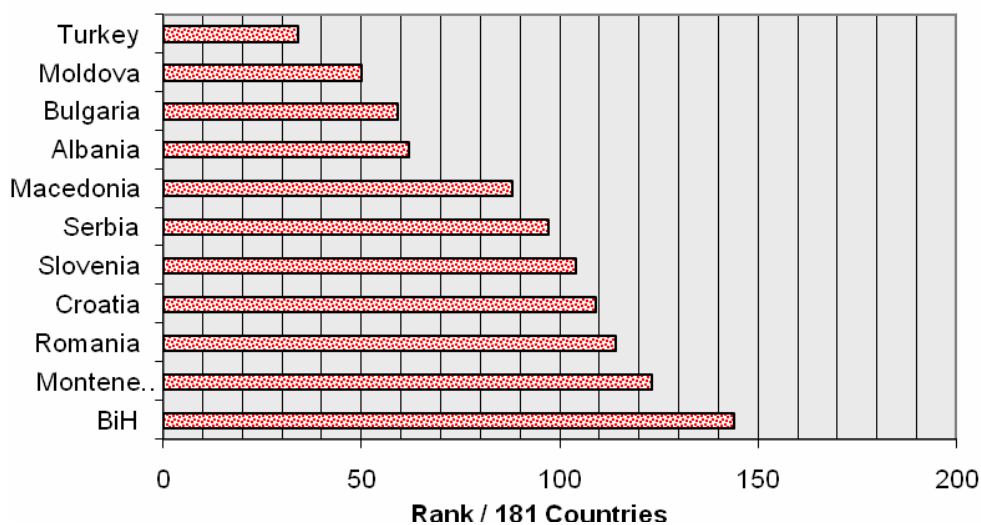


Chart 3

**Registering Property**



Macedonia ranks first in SEE in business start-up, with Romania, Slovenia, and Turkey also in the top 50. BiH is far behind next-to-last Croatia. In registering property, Turkey is in first place, and BiH is again well in last.

The deterioration in BiH's ranking is not necessarily because the business environment is getting worse – some improvements have been made. However, other countries have committed themselves to reform far more aggressively than BiH, and are improving much faster than BiH. This means that BiH still loses, despite its modest advances: foreign investment will be attracted elsewhere, since investors have a choice.

In June 2008, the World Bank published one of its Doing Business surveys focused only on major cities in Southeast Europe. Out of the 22 cities covered in Serbia, Macedonia, Albania, Croatia, and Bosnia and Herzegovina, the three largest cities of BiH unfortunately held the last three places for the ease of registering a business – Banja Luka was 20<sup>th</sup>, Sarajevo was 21<sup>st</sup>, and Mostar was 22<sup>nd</sup>. When it comes to the time it takes to obtain all licenses needed for commercial construction, Mostar was again last (530 days), Sarajevo was next to last (470 days), and Banja Luka was only 16<sup>th</sup> (300 days). In the ease of registering property, Banja Luka, Sarajevo, and Mostar again held the bottom three positions in the ranking, requiring 5 to 10 months in terms of time and 7 to 11 separate procedures. These are extremely disappointing results for the major economic centers of our country.

The FIC is concerned primarily with improving business, legal and regulatory issues. In this White Book we cover four key areas: registering a business, obtaining work and residence permits for foreign employees, reforming taxes, and obtaining construction permits. As in our first White Book (published April 2007), we are not attempting to present an exhaustive survey of all reforms needed. Rather, we wish to identify a short list of priority reforms that can realistically be implemented within the next 12 months. Unfortunately, some of our priorities are items that were presented 18 months ago in our first White Book, which we thought could have been implemented during year 2007, but were not.

In order to make the adoption of recommended reforms more feasible, we have narrowed our focus somewhat in this White Book – to four subject areas, rather than the previous five. We have continued with business registration permits, taxes, and construction permits, but dropped business finance and trade policy, while adding work permits for foreigners. We have also tried to be more specific and focused in our individual recommendations within these areas. The following table summarizes the four subject areas and draws our “top 10 list” of desired individual reform recommendations in these areas.

Table 1 Addressing Obstacles in 2008

Area	Identified Issues	Key Recommendations
<b>Business Registration</b>	<ul style="list-style-type: none"> <li>• Notaries</li> <li>• Foreign investment registration at BiH Ministry of foreign trade and economic relations</li> <li>• Cantonal/municipal inspectorates</li> <li>• Municipal courts</li> </ul>	<p><b>Legislation:</b></p> <ul style="list-style-type: none"> <li>• Full implementation of the Law on Electronic Signature</li> <li>• Introduce “solemnizacija” process – between attorney and notary</li> <li>• In FBiH, allow companies to be registered and start operating based on the registrant’s declaration, with premises inspections thereafter</li> </ul>

Area	Identified Issues	Key Recommendations
		<p><b>Practical Aspects:</b></p> <ul style="list-style-type: none"> <li>• Establish a One-Stop Shop for the business registration process</li> <li>• Establish "e-registration" – online business registration</li> <li>• Establish a telephone public information service in the registration departments of the courts</li> <li>• Post on respective state/entity's institutions web sites information on registration process</li> </ul> <p><b>Human Resources Management:</b></p> <ul style="list-style-type: none"> <li>• Improve managerial organization of institutions</li> <li>• Improve technical knowledge and efficiency of institutional staff</li> </ul>
<p><b>Temporary Residence and Work Permits</b></p>	<ul style="list-style-type: none"> <li>• Temporary residence permit</li> <li>• Work permit</li> <li>• No criminal record</li> <li>• Medical examination</li> <li>• Provision of documents – duplication, confidentiality, inconsistency</li> <li>• Unequal standards</li> </ul>	<p><b>Legislation:</b></p> <ul style="list-style-type: none"> <li>• Harmonize state, entity and cantonal laws and adjust the procedure for obtaining/extending temporary residence and work permits</li> <li>• For aliens/directors who are not staying in the country for more than 3 months during a year, simplify the procedure for residence permit or appointment as an authorized person.</li> <li>• Enable issuance of White Card at passport control units</li> <li>• Application of the Framework Law on Higher Education</li> </ul> <p><b>Practical Aspects:</b></p> <ul style="list-style-type: none"> <li>• Publish procedures for obtaining/extending temporary residence and work permit at the web sites of respective institutions involved in the process</li> <li>• Accept applicant's affidavit of no prior criminal record, and make it BH Ministry of Security's responsibility for further inquiry</li> <li>• Accept medical examination documents from foreign licensed M.D.'s, and expand the list of BiH institutions authorized to conduct medical examinations</li> </ul> <p><b>Customer Services:</b></p> <ul style="list-style-type: none"> <li>• Enhance communication, exchange of information and cooperation between institutions</li> </ul>

Area	Identified Issues	Key Recommendations
<p><b>Taxes</b></p>	<ul style="list-style-type: none"> <li>• Bilateral agreements with international institutions on dual taxation avoidance</li> <li>• Corporate Income Tax:               <ul style="list-style-type: none"> <li>• Dual taxation</li> <li>• Dividends, capital gain withholding tax</li> </ul> </li> <li>• Tax treatment of general and special provisioning with banks in FBiH</li> <li>• Real estate taxation</li> <li>• VAT filing and refund</li> </ul> <p>Brčko Distrikt:</p> <ul style="list-style-type: none"> <li>• Income Tax (personal/corporate)</li> <li>• Accounting standards</li> </ul>	<p><b>Legislation:</b></p> <p>Corporate Income Tax</p> <ul style="list-style-type: none"> <li>• Harmonization of law between the entities and Brcko District, enabling submission of only one tax return as per the location of the principal place of business of the taxpayer.</li> <li>• Harmonization of taxation of dividends and capital gain between RS and FBiH</li> <li>• The legal deadline for tax return filing should be pushed from the 10<sup>th</sup> to 15<sup>th</sup> of the month, and VAT payment deadline should be 7 days from the deadline for filing of the return.</li> </ul> <p>Brcko District</p> <ul style="list-style-type: none"> <li>• Introduction of two separate laws: Corporate Income Tax Law and Personal Income Tax Law that will be harmonized with entities laws</li> </ul> <p><b>Practical Aspects:</b></p> <ul style="list-style-type: none"> <li>• Publish all bilateral tax agreements on respective websites of the BiH Ministry of Foreign Trade and Economic Relations and the Ministry of Treasury and Finance</li> <li>• Amend and extend bilateral tax agreements with all relevant countries to avoid double taxation and regulate mutual recognition of social insurance payments and rights</li> <li>• In Brcko District tax authorities should issue an instruction for taxpayers with the principal place of business in RS and FBiH on how to properly calculate tax liabilities, i.e. how to complete the tax return.</li> <li>• To enable simpler sales of new real estate, which is subject to VAT, make sale of real estate subject to VAT computation, as long as such sale is made between persons operating within VAT system</li> </ul>
<p><b>Construction Permits</b></p>	<ul style="list-style-type: none"> <li>• Lack of spatial, urban and regulatory plans</li> <li>• Complex procedure</li> <li>• Disrespect of legally binding deadlines and lack of coordination among various institutions</li> </ul>	<p><b>Practical Aspects:</b></p> <ul style="list-style-type: none"> <li>• Create a database with information on a status of spatial, urban and regulatory plans for all municipalities</li> <li>• A handbook for businesses should be created along with roadmap for obtaining all approvals and permissions, with respective legislation,</li> </ul>

Area	Identified Issues	Key Recommendations
		<p>forms, and institutions involved in the overall process</p> <ul style="list-style-type: none"> <li>• Develop a priority system where officials will sort all incoming request according to the following criteria, and functionally reorganize accordingly:               <ul style="list-style-type: none"> <li>• Civil or private sector</li> <li>• Project value</li> <li>• Priority (if needed introduce VIP treatment )</li> </ul> </li> <li>• Use of information technology and GIS systems at the state level in order to reduce paper work and improve processes</li> </ul> <p><b>Human Resources Management:</b></p> <ul style="list-style-type: none"> <li>• Enhance capabilities of officials in order to improve customer service for citizens and businesses</li> </ul>

BiH has a far greater potential to attract investment and to grow than it is currently realizing.

As many countries have shown, these issues are not difficult to address if the executive and legislative branches of government are committed to reform. We ask: why is this not the case in BiH, a country whose citizens long for more jobs and better pay? We again urge leaders to adopt an attitude of radical reform. This is even more important at the current juncture, with the world economy entering a recession.

The FIC cares – not just about the interests of our members, but about the overall economic growth in BiH, because that is ultimately what our business depends upon.

### **3. ABOUT FOREIGN INVESTORS COUNCIL**

Established in August 2006, the FIC is a business association representing the interests of foreign companies in BiH. The FIC aims to be the single voice of the foreign investors in the country. The purpose of the FIC is to regularly and strongly communicate the key impediments in the business environment to state and entity officials.

At the moment FIC has 27 members and their total investment in the country exceeds € 4 billion. The FIC Membership comes from various sectors including audit/finance, dairy, energy, financial services, hotel management, legal services, pulp, real estate and telecommunications.

*FIC promotes change in the business environment through:*

- Regular forums with high ranking officials
- On-going dialog with government representatives
- Regular contacts with local and international institutions and organizations
- Advocacy activities

*FIC fosters cooperation among Members through:*

- Informal events
- Formal events such as forums, official meetings, support team gatherings
- Charity events

*FIC provides practical support:*

- White Book – outlining the most pressing issues and obstacles in the business environment
- Support Teams – the FIC provides key recommendations on areas which effect all businesses in BiH
- Provide critical information to media representatives
- Providing potential investors with practical advice

## **4. OBSTACLES TO INVESTMENT**

The 2008 edition of the White Book is looking into four areas that are important for the future inflow of investments in the country. Compared to the previous edition, this one is going into more specifics, identifying bottlenecks in the processes, underling unaligned legislation and providing recommendations.

The following areas are covered:

- Business Registration
- Temporary Residence and Work Permits
- Taxes
- Construction Permits

Each section provides (i) a table summarizing strengths, weaknesses, and governance authorities in the area, (ii) a narrative overview of the key issues and (iii) a presentation of major recommendations for reform.



## 4.1 BUSINESS REGISTRATION

Prior to entering a new country, foreign investors analyze a number of key factors that will be crucial in their decision making. One of the factors will be the ease with which a business can be registered and begin operations. Business registration remains a major barrier to FDI in Bosnia and Herzegovina.

Table 2

<b>Starting a Business – Foreign Company</b>	
<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• Laws are straightforward</li> <li>• Relatively low fees</li> </ul>	<p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• Law on electronic signature is not being practiced</li> <li>• Deadlines defined by laws are not respected</li> <li>• Different practices applied even within the same institution with enormous variance in the time taken</li> <li>• No central place where all information on the registration process can be obtained<sup>2</sup></li> <li>• No availability of information in electronic form in local and/or a foreign language: forms, respective laws, samples of documents, list of notaries, list of attorneys, frequently asked questions, etc.</li> <li>• Lack of coordination and communication among institutions</li> <li>• Insufficient number of staff members that are handling registration</li> <li>• Un-trained staff members in courts and inspections</li> <li>• Inadequate customer service support</li> <li>• Inadequate information management and communications technology</li> </ul>
<p><b>Key Institutions Involved:</b></p> <p><b>State level:</b></p> <ul style="list-style-type: none"> <li>• Bureau for Indirect Taxation</li> <li>• Ministry of Foreign Trade and Economic Relation</li> </ul> <p><b>Entity level:</b></p> <ul style="list-style-type: none"> <li>• Directorate for Statistics</li> <li>• Directorate for Pension Insurance</li> <li>• Directorate for Health Insurance</li> <li>• Ministry of Finance, Tax Bureau (RS)</li> <li>• Ministry of Trade (FBiH)</li> </ul> <p><b>Cantonal level (FBiH):</b></p> <ul style="list-style-type: none"> <li>• Inspectorate</li> <li>• Ministry of commerce</li> </ul> <p><b>Municipal level:</b></p> <ul style="list-style-type: none"> <li>• Court</li> <li>• Department for Economy and finance (FBiH)</li> <li>• Inspectorate (RS)</li> <li>• Tax Authority (FBiH)</li> </ul>	

It takes a minimum of three months for a foreign-owned company to register their company, starting from the day a company initiates the process to the moment it is allowed to legally operate. This places Bosnia and Herzegovina at a distinct disadvantage with its neighbors, all of whom have a easier business registration process. The World Bank's "Doing Business" report on South East Europe for 2008 has been focusing on the time it takes to register domestically owned companies in the region by comparing cities as well as countries. Out of 22 cities that were compared from seven countries<sup>3</sup>, three BH cities – Banja Luka, Mostar and Sarajevo – were at the bottom of the list.

<sup>2</sup> Websites such as: Croatia [www.hitro.hr](http://www.hitro.hr), Serbia [www.apr.sr.gov.yu](http://www.apr.sr.gov.yu)

<sup>3</sup> Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Kosovo, Montenegro and Serbia

This result is far from encouraging. In the latest Doing Business Report for 2009, under the section ease of starting a business, out of 181 countries assessed BiH is ranked 161, behind FYR Macedonia (12), Slovenia (41), Albania (67) Serbia (106), Croatia (117), but also Ghana, Brunei, Guatemala, etc. The table below summarizes the number of steps and time required to register a business in BiH, including a comparison with neighboring countries.

Table 3 Ease of Starting a Business

Description	2007	2008	2009
<b>Albania</b>			
Steps	11	10	6
Days	39	36	8
Rank	121	123	67
<b>BiH</b>			
Steps	12	12	12
Days	54	54	60
Rank	141	150	161
<b>Croatia</b>			
Steps	10	8	8
Days	45	40	40
Rank	100	93	117
<b>FYR Macedonia</b>			
Steps	10	9	7
Days	18	15	9
Rank	76	21	12
<b>Serbia</b>			
Steps	10	11	11
Days	18	23	23
Rank	60	90	106
<b>Average Eastern European countries</b>			
Steps	na	8,8	7,7
Days	na	26,2	22,6
<b>Average OECD countries</b>			
Steps	na	6	5,8
Days	na	14,9	13,4

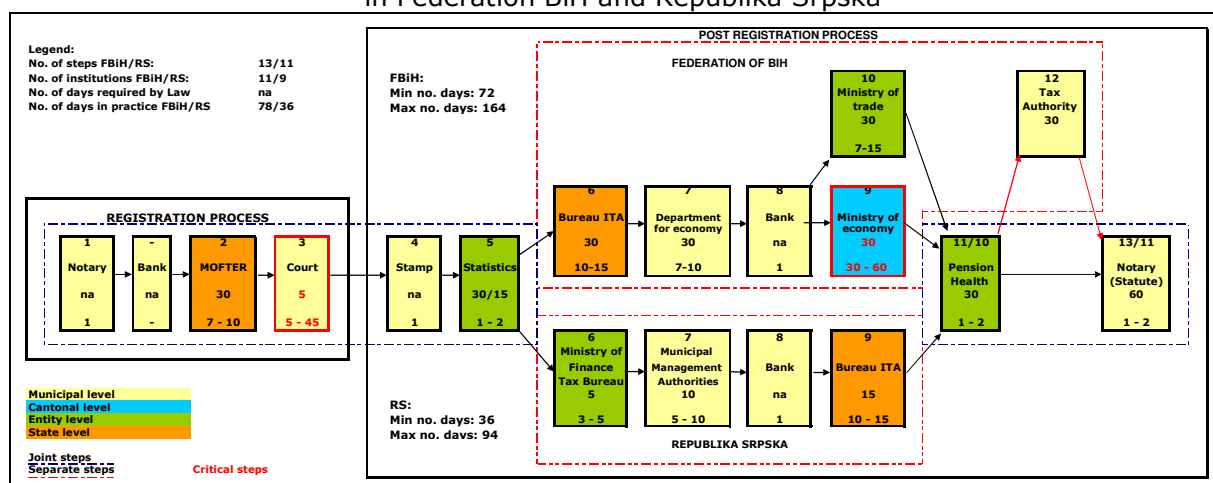
No.	City	Country
1	Bitolj	FYR Macedonia
2	Skoplje	FYR Macedonia
3	Shkodra	Albania
4	Tirana	Albania
5	Vlora	Albania
6	Pljevlje	Montenegro
7	Podgorica	Montenegro
8	Nikšić	Montenegro
9	Uzice	Serbia
10	Krusevac	Serbia
11	Beograd	Serbia
12	Vranje	Serbia
13	Zrenjanin	Serbia
14	Prizren	Kosovo
15	Pristina	Kosovo
16	Sibenik	Croatia
17	Osijek	Croatia
18	Zagreb	Croatia
19	Varazdin	Croatia
20	Banja Luka	Bosnia and Herzegovina
21	Sarajevo	Bosnia and Herzegovina
22	Mostar	Bosnia and Herzegovina

Source: World Bank Doing Business Reports 2007, 2008, 2009

There exist many reasons for the process lasting so long in BiH, but it is evident that in the last three years BiH authorities have not been successful in keeping pace with regional improvements. While FYR Macedonia and Albania succeeded to dramatically shorten the process; in BiH the number of procedures and days remained unchanged. Furthermore, the efficiency of various institutions failed to improve during the same period.

Under the registration period we assume the day a company starts dealing with a public notary, and ends when the company becomes operational. The chart below shows the steps needed and the institutions involved in the process, the deadlines defined by law, and the time needed in practice to complete all steps. The World Bank report focused on the two cities where most of economic activities are happening, and showed that these also have the most inflexible systems – Sarajevo and Banja Luka.

Chart 4 Business Registration Process of Foreign Company in Federation BiH and Republika Srpska



The registration timeframe varies dramatically between the entities. Even if institutions were efficiently processing incoming requests, the whole process would last a minimum of 36 days in Banja Luka, and 72 days in Sarajevo. In practice, according to the experiences of various foreign companies it takes approximately around 50 days in Banja Luka, and 90 days in Sarajevo to complete all steps. The registration process is significantly delayed by municipal court procedures, and in Sarajevo the Cantonal Inspectorate is identified as a major cause of delay.

Overall, the process is delayed as a result of involvement of multiple institutions at the state, entity, and cantonal/municipal levels, officials do not process incoming requests efficiently, and often request additional documents that are not required by law.

### SURVEY: ISSUES AND RECOMMENDATIONS

The FIC's analysis of the experiences of foreign companies that completed the registration process confirms that the key obstacles, often overlapping are interminable and tortuous procedures, and inconsistency and unpredictability of officials. We now present the specific issues raised and our recommendations for addressing them.

- **Notaries**

#### ISSUE

In May 2007 notaries were introduced by law in the Federation of Bosnia and Herzegovina (FBiH), and in March 2008 in Republika Srpska (RS). In both entities, the law requires that a notary formally reviews a company's founding act and all changes in the company statute<sup>4</sup>. Irrespective of how the notary system may have been designed the reality is that companies continue to work through lawyers even when notaries have exclusivity.

#### RECOMMENDATION

In Croatia this overlap has caused the authorities to introduce the idea of "solemnizacija" whereby contracts and other documents are notarized on the basis not of the content but rather of the form and practice. "Solemnizacija" is a process of contract validation whereby a

<sup>4</sup> Federation of BiH, Law on Notaries, Article 73; Republika Srpska Law on Notaries, Articles 68 and 69

notary verifies that the contract drafted by another person who is not a notary is written in the satisfactory form and also explains to the contracting parties the legal consequences of the signed document.

- ***Foreign Investment Registration at BiH Ministry of Foreign Trade and Economic Relations***

#### **ISSUE**

According to the state Law all foreign investments have to be registered at the Ministry of Foreign Trade and Economic Relations (MOFTER). Often this step takes around 14 working days, and additional information is required by officials, so the process lasts much longer in practice. This additional hurdle provides the foreign investor with an additional level of risk and uncertainty, propagated by the fact that in reality most requests are supplemented by a call for additional documents which are called upon and processed in an arbitrary manner.

#### **RECOMMENDATION**

Replace the requirement for MOFTER positive approval with a requirement for notification and opportunity for disapproval, and integrate this with the company registration process. Registration of foreign investments at the Ministry could be integrated with the procedure of registration of the company before the court. The court could deliver the copies of received documents to the Ministry of Foreign Trade for review, at the same time when considering application for the registration of the company. MOFTER positive approval would not be a condition for registration, but MOFTER could disapprove based only on existing national security-related legal strictures, within a limited time period.

- ***Cantonal/Municipal Inspectorates***

#### **ISSUE**

Without all required permits a company cannot start its activities. In the FBiH, permits are issued by both municipal and cantonal inspectorates. In Sarajevo Canton, for example, just 9 inspectors are available, covering 5 different areas (environment, sanitary, labour, fire prevention and market inspection), and it often takes at least two months for inspectors to visit business premises and issue a decision. They are organized in teams of two or three representatives when visiting a single location. On an annual basis, Sarajevo Canton inspectors receive between 3500 and 4000 requests. With these limited human resources, incoming requests cannot be processed efficiently.

#### **RECOMMENDATION**

In RS legislation has been changed. A company can start its activities, while premises can be inspected later. FBiH should introduce a similar practice. Also, inspection and all documents should be issued by only one institution, either on municipal or cantonal level. In addition, companies will benefit if incoming requests are better managed.

- ***Municipal Courts***

#### **ISSUE**

In comparison to 2007, registration at some municipal courts has been improved dramatically. However there are different practices with enormous variance in the time across the country. The usual timeframe for a company to obtain court documents varies

from 5 to 45 days. In most major cities, the number of staff members handling the registration process is inadequate for the number of requests to be processed at court.

### **RECOMMENDATION**

In order to improve the efficiency of court unit that is handling registration process, additional human resources should be allocated. Registration staff should be trained so that they do not request additional documents not required by laws and bylaws, as often now happens.

Registration courts should introduce and implement e-registration – company registration through the internet. This would require full implementation of the Law on Electronic Signature of BiH too.

Finally, the courts should also establish a telephone public information service for questions regarding the registration process, which would reduce the crowds of people in front of court premises.

- ***Law on Electronic Signature***

### **ISSUE**

Since November 2006, the Law on Electronic Signature is being enforced at the State level, but the Law is still not being implemented in FBiH. Since June 2008, the Law on electronic signature of Republic of Srpska entered in force. However, the Law is not being implemented in day-to-day.

### **RECOMMENDATION**

Implement the Law on Electronic Signature at the entity level.

*Summary of Recommendations*

**BUSINESS REGISTRATION**

• **Legislation:**

- In FBiH, allow companies to be registered and start operating based on the registrant's declaration, with premises inspections thereafter
- Introduce "solemnizacija" process – between attorney and notary
- Full implementation of the Law on Electronic Signature
- Require deadlines defined by law to be respected by courts in both entities and inspectorates in FBiH

• **Practical Aspects:**

- Establish a One-Stop Shop for the business registration process
- Establish "e-registration" – online business registration
- Establish a telephone public information service in the registration departments of the courts
- Post on respective state/entity's institutions web sites information on registration process outlining:
  - all steps and related expenses
  - contact details for all institutions involved in the process
  - respective laws, bylaws and rulings
  - forms in electronic form in local and a foreign language
  - list with attorneys, notaries, etc.
  - frequently asked questions

• **Human Resources Management:**

- Improve managerial organization of institutions
- Improve technical knowledge and efficiency of institutional staff

## 4.2 TEMPORARY RESIDENCE AND WORK PERMITS

The process of obtaining temporary residence and work permit for aliens is demanding in most countries, but in Bosnia and Herzegovina it is even more complex and time consuming.

Table 4

<b>Temporary Residence and Work Permits</b>	
<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• -</li> </ul>	<p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• Contradictions between the state Law on Movement and Stay of Aliens and Asylum and (i) the Federal Law on Employment of Aliens, and (ii) the Republic of Srpska Law on Employment of Aliens and Persons Without Citizenship</li> <li>• Foreign educational diplomas are not recognized and must be validated</li> <li>• Issuing/obtaining the proof of no criminal record for aliens engaged/employed for a limited period of time in different locations throughout the world, or for those whose home countries do not have a practice of issuing the proof of no criminal record</li> <li>• Complicated procedures with competent bodies</li> <li>• No observance of legal deadlines</li> <li>• For the work permit extension procedure, verified copies are required of documents previously submitted</li> <li>• Lack of understanding for investors and lack of support in the process of issuing temporary residence and work permits</li> <li>• Inefficiency of the administrative staff in terms of providing adequate support during permit application processing</li> </ul>
<p><b>Key institutions involved:</b></p> <p><b>State Level:</b></p> <ul style="list-style-type: none"> <li>• Ministry of Security – Aliens’ Service (temporary residence permit)</li> </ul> <p><b>Entity Level:</b></p> <ul style="list-style-type: none"> <li>• Public Institution – Employment Service of the Federation of BiH (work permit)</li> <li>• Republic of Srpska Employment Bureau (work permit)</li> </ul> <p><b>Cantonal Level:</b></p> <ul style="list-style-type: none"> <li>• Public Institution – Employment Service of (FBiH) (work permit)</li> </ul> <p><b>Municipal Level:</b></p> <ul style="list-style-type: none"> <li>• Employment Bureau (in individual municipalities) (work permit)</li> </ul>	

During 2007, 2,731 work permits were issued in BiH, which is by 20% more relative to 2006. Looking at the period of the first eight months in 2008, relative to the same period in 2006, the number of issued permits has increased by 129%.

The number of issued work permits in Banja Luka is growing each year. In 2007, 243 were issued, and during the eight months in 2008 – 277 permits. In FBiH, Sarajevo Canton issues about 800 work permits per year, or 50% of the total number of issued permits in FBiH, with Zenica-Doboj and Tuzla Cantons issuing 10% each. Since the highest number of applications gets filed and processed in Sarajevo Canton, the procedure for issuing/extending the work permit takes the longest in this Canton.

The Table below indicates the number of filed applications from 2005 until August 2008, as well as the percentage share of applicants as per their respective citizenship.

Table 5  
Total number of issued work permits

	2005	2006	2007	(I-VIII) 2008
FBIH	66%	59%	55%	55%
RS	16%	22%	28%	35%
Distrikt Brcko	18%	19%	17%	15%
Total number:	2351	2284	2731	1991
Participation of two major cities in total number of issued permits:				
Sarajevo	35%	31%	27%	30%
Banja Luka	6%	6%	9%	16%
Citizenship:				
Serbia	-	35%	38%	
China	-	23%	17%	
Croatia	-	12%	12%	
Turkey	-	9%	8%	
Other	-	21%	25%	

Source: Agency for employment BiH, RS Agency for employment, District Brcko government

There are significant differences across BiH in fees for work permits amount. The FBIH Budget Audit Office proposed, and the Sarajevo Canton Assembly adopted on September 12, 2008 an additional fee is charged in Sarajevo Canton, which is allocated to the Sarajevo Canton Budget. Per year, an alien now needs to provide 1350 KM in fees solely to obtain the work permit in Sarajevo Canton. This is far higher than in neighboring countries: in Croatia a work permit costs the equivalent of 200 KM<sup>5</sup>, and in Serbia around 500 KM<sup>6</sup>, depending on the position in a company. The table below indicates all expenses related to the work permit application processing. In addition, the temporary residence permit costs 100 KM per year. In RS, one needs to pay in fess 150 KM for temporary residence and work permit. At the table below are presented all expenses related to work permit.

Table 6  
Taxes and related expenses

<b>Taxes:</b>	<b>KM</b>	<b>Additional expenses (annual basis):</b>	<b>KM</b>
<b>Bosnia and Herzegovina</b>			
<b>Federation BiH, Cantons:</b>			
Hercegovacko-neretvanski	200	Medical examination	150 -180
Sarajevski Canton	1350	Photocopies	30-60
Tuzlanski Canton	200	Stamps	30-60
Zenicko-dobojski Canton	250	Court approved interpreter	80
<b>Republika Srpska:</b>		Nostrification (FBIH)*	800-2500
Banja Luka	50	Diploma recognition (RS)*	300
<b>Croatia</b>	200		
<b>Serbia</b>	500		

\* one time fee

<sup>5</sup> Source: PricewaterhouseCoopers Hrvatska

<sup>6</sup> Source: PricewaterhouseCoopers Srbija, Karanovic & Nikolic Srbija



## **SURVEY: ISSUES AND RECOMMENDATIONS**

The Law on Movement and Stay of Aliens and Asylum was adopted in May 2008 at the State level. Some Articles in the Law are not clearly defined or are in conflict with the Federal Law on Employment of Aliens and with procedures for obtaining a work permit with the Employment Services. In addition, the State law is also in disharmony with the Republic of Srpska Law on Employment of Aliens and Persons without Citizenship. Difficulties occur in BiH practice due to uncoordinated instructions from the RS Employment Bureau and the Aliens' Service within the Ministry of Security.

Frequently the applicant is required to deliver documents from one institution to another. It would be more practical if state and entity institutions would cooperate and exchange information. For instance, in Croatia, one institution (the Ministry of Interior) is in charge for the process of issuing both the temporary residence and the work permit.

The process of obtaining/extending temporary residence and work permits in Sarajevo Canton takes two months at best. Below, based on a survey of FIC members, we review the specific problems in obtaining both permits for foreign staff, with recommendations for resolution.

- ***Temporary Residence Permit***

### **ISSUE**

To reside in BiH for any length of time, the alien must obtain a "White Card" from the BiH Ministry of Security – Aliens' Service. White Card records the alien's residence address, and planned length of stay. To obtain the White Card, the alien must go to the police department together with the lessor of his/her apartment.

In addition, upon receiving a work permit, and in order to apply for temporary residence permit, an alien must leave the country and return and report again to the Ministry to obtain a revised residence permit. These requirements for personal attendance are duplicative and costly.

### **RECOMMENDATION**

The extremely inefficient requirement that, in order to apply for temporary residence permit, an alien must leave BiH territory, return to the country and report again in person to the Ministry, should be eliminated. The number of personal attendances in the BiH Ministry of Security could be reduced to only one visit to the institution, where a possibility would be left for any additional documents to be supplied subsequently by an authorised person.

Commonly, an alien would not be able to enter a lease agreement within the short period of time (nn days) in which the White Card must be obtained. Therefore he/she must appear in person to obtain a new White Card when an apartment is found. An alien should be able to be registered for the second time by the person providing the dwelling. Even better, the White Card could be issued and updated at passport control during entry into BiH, as is the practice in many other countries.

- ***Work Permit***

#### **ISSUE**

**Articles within the state law contradict** – Articles 52 and 81 of the state Law on Movement and Stay of Aliens and Asylum contradict with each other. Article 52 says that precondition for temporary stay is an issued work permit and signed employment contract. Article 81 says that the first temporary stay has to be obtained and then an employment contract can be signed.

#### **RECOMMENDATION**

Articles to be harmonized and additional explanations and instructions provided for articles in the laws which lack precision. Article 81 of the Law on Movement and Stay of Aliens and Asylum or the respective procedures of the Cantonal Employment Bureaus must be revised, and the situations in which an alien needs or does not need to sign an agreement with the employer must be clearly stated and same practice apply in every single case.

- ***No Criminal Record***

#### **ISSUE**

Issuing/obtaining the proof of no criminal record frequently constitutes a problem for aliens, particularly for persons who are for a designated period of time engaged/employed in various locations throughout the world or whose home countries do not have the usual practice to issue proofs of no criminal record.

#### **RECOMMENDATION**

Aliens should be allowed to swear to a no criminal record affidavit and obtain work/temporary residence permits, and follow up with documents if required. For aliens whose home countries do not have the usual practice of issuing proofs of no criminal record, the BiH Ministry of Security should provide support and request information through its channels. Also, it would be useful if the Ministry would list, on its web site, the institutions which can issue the proof of no criminal record for the countries which have invested into BiH so far. In addition, staff implementing the Law and procedures need training to apply them equally and accurately.

- ***Medical Examination***

#### **ISSUE**

For a work permit, aliens are required to undergo a medical examination in BiH, although such examination could be performed in any other country by a licensed M.D. and documents submitted in BiH. Another problem is the fact that only 4 institutions in Sarajevo Canton area are authorized to issue medical certificates. A blood work certificate issued by private clinics is acceptable, but this is not the case for any other medical or lab work.

#### **RECOMMENDATION:**

Allow foreign managers to undergo the respective medical examinations in their home countries and submit those documents. Meanwhile, expand the list of institutions in BiH that can provide medical examination.

- ***Provision of Documents – Duplication, Confidentiality, Inconsistency***

**ISSUE**

For work permit extension, copies need to be provided of documents that were already filed for obtaining the original work permit (copies of diplomas, company registration, passports, etc.). Also, even though some documents are confidential (balance sheet), institutions insist for these to be supplied. Sometimes additional documentation is demanded, which is irrelevant for the respective procedure eg. the Federal Employment Bureau sometimes requires documentation from relevant institutions in RS, although the work permit is issued at the Entity level, which would lead to a conclusion that the above-mentioned institution has no right to ask for documents from another Entity.

**RECOMMENDATION**

Create a register for aliens, so that the same documents would not have to be supplied several times. Establish an electronic database to enable the exchange of information between employment services.

Reduce the list of documents required for work permit extension. For example, verified copies of individual decision documents and decisions pertaining to changes in any respective company are frequently asked for, even though these have all been previously filed and are clearly visible in the court registry excerpt.

- ***Unequal Standards***

**ISSUE**

Even when the competent service accepts the submitted work permit documentation as complete and forwards/submits it to a higher instance, in practice, frequently, the higher instance body requires additional documents, which are nowhere prescribed under the procedures, stalling the process.

**RECOMMENDATION**

Improve communication, exchange of information, and cooperation between the Ministry of Interior, Employment Bureau, and BiH Ministry of Security, as well as the cooperation between cantonal and federal employment bureaus.

**OTHER RECOMMENDATIONS**

**Observing legal deadlines** – Competent institutions need to adhere to prescribed legal deadlines, or if not, bear the consequences for any additional requirements in terms of documents the supply of which is not foreseen under the Law or the procedures. The Law foresees for the temporary stay procedure to be completed within 30 days, as of the day of filing of a proper application supported by prescribed documentation, which is often not the case in real life.

**Aliens staying in the country for up to 3 months** – For aliens/directors who are not staying in the country for more than 3 months during a year, simplify the procedure for temporary residence permit or appointment as an authorised person.

**Lack of understanding for large investors** and lack of support during the process of issuing temporary residence and work permit. The Law defines for the Council of Ministers to

be able to grant incentives for issuing work permits; however, it nowhere defines who is entitled to such incentives. To that extent, it should be further explained what these incentives imply, which investors/aliens they are intended for, etc.

**Foreign educational diplomas are not recognized and must be validated** – Framework Law on Higher Education in BiH entered to force in August 7, 2007. The Law envisions establishment of the Centre for Recognition and Information on state level. Till today, this Centre is not established. In addition, the Law does not clearly define authorities and responsibilities of this Centre. Entities, FBiH Cantons and Brcko District were obliged to harmonize their laws with the State Framework Law on Higher Education. At the moment, different practices in acceptance and validation of foreign diplomas are applied.

*Summary of Recommendations*

**TEMPORARY RESIDENCE AND WORK PERMITS**

• **Legislation:**

- Harmonize state and entity laws and adjust the procedure for obtaining/extending temporary residence and work permits
- For aliens/directors who are not staying in the country for more than 3 months during a year, simplify the procedure for residence permit or appointment as an authorised person.
- Enable issuance of White Card at passport control units
- Application of the Framework Law on Higher Education

• **Practical Aspects:**

- Publish procedures for obtaining/extending temporary residence and work permit at the web sites of respective institutions involved in the process
- Accept applicant's affidavit of no prior criminal record, and make it BH Ministry of Security's responsibility for further inquiry
- Accept medical examination documents from foreign licensed M.D.'s, and expand the list of BiH institutions authorized to conduct medical examinations

• **Customer Services:**

- Enhance communication, exchange of information and cooperation between institutions

### 4.3 TAXES

Inconsistency and complexity of the enterprise taxation system remains an impediment to investments for companies operating throughout the country.

Table 7

<b>Taxes</b>	
<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>• VAT has been in application throughout the country as of January 01, 2006, at the single rate of 17%; the VAT refund system is implemented to a large extent</li> <li>• Customs duties, excise, and VAT revenues are collected at the State level</li> <li>• New Personal Income Tax Law adopted in FBiH is to enter into force as of January 1 2009, and it is to contribute to harmonization of tax rates and taxation principles applicable to income of natural persons in FBiH with that of RS and BD</li> <li>• The reduction of the corporate income tax rate from 30 to 10 percent in FBiH means that rates in both entities are no longer unequal</li> <li>• The FBiH Corporate Income Tax Law exempts exporters from corporate income tax (in case at least 30% of the respective total revenue is from export activities), as well as investments into production activities exceeding 20 mil. KM over a five-year period</li> <li>• Taxpayers which initially exercised the right to tax incentives under the old Corporate Income Tax Law in FBiH for the purpose of foreign ownership, newly established enterprises, and free zones, are able to use the incentives until the expiry of the given period under the old Law</li> <li>• The new FBiH Corporate Income Tax Law resolved the dual taxation problem for companies with principal place of business in FBiH but realizing revenues and paying tax through subsidiaries in RS and BD. Similarly, companies with principal place of business in RS and BD, which operate in FBiH through subsidiaries, have no obligation to file a tax return in FBiH.</li> </ul>	<p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>• Lack of harmonization between state, entity, and cantonal level legislation</li> <li>• Corporate Income Tax Law – balanced rates, not the principles (dual taxation between FBiH, RS and Brcko District present in practice, withholding tax, tax reliefs, etc.)</li> <li>• Unequal contributions rates for social insurance throughout the country</li> <li>• Differing interpretation and treatment, under the same tax laws, by tax authorities in different administrative units</li> <li>• Lack of a central electronic database, which would store all tax laws, changes to laws, rulebooks, frequently asked questions, and applied practice</li> <li>• Lack of central registry of bilateral agreements entered into by BiH or inherited by it as the legal successor of SFRY: on avoiding dual taxation, social insurance agreements, on accession of BiH to international institutions</li> <li>• The BD Income Tax Law as a single law for taxation of legal and natural persons is impractical, unclear, and disharmonized with the laws and principles of taxation applied in FBiH and RS. Among other things: <ul style="list-style-type: none"> <li>○ The principle of modified cash accounting model for calculation of tax liabilities in BD is unclear for both, the taxpayers and tax inspectors.</li> <li>○ Inability to use the tax paid in BD as a tax credit in RS and FBi</li> </ul> </li> </ul>

<p><b>Key institutions of authority:</b></p> <p><b>State Level:</b></p> <ul style="list-style-type: none"> <li>• BiH Indirect Taxation Authority</li> </ul> <p><b>Entity Level:</b></p> <ul style="list-style-type: none"> <li>• Ministries of Finance</li> <li>• Tax Administrations</li> </ul> <p><b>Cantonal Level:</b></p> <ul style="list-style-type: none"> <li>• Tax Administrations</li> </ul> <p><b>Municipal Level:</b></p> <ul style="list-style-type: none"> <li>• Municipal/Local Tax Offices</li> </ul>	
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One of the most pressing obstacles for companies that are operating across the country is unaligned legislation. Over the past years, some companies were subject to double taxation between entities and Brcko District. Not only that the legislation was ignored but there was none on any governmental level, which had offered to solve this double taxation case.

With the Corporate Income Tax Law entering into force in FBiH a step forward has been made with respect to avoidance of double taxation within BiH. We await the actual experiences of business people in the current year, the first for application of the new law.

The list of pending issues in the domain of direct and indirect taxes is quite extensive. The FIC highlights only some of them in this report.

## **SURVEY: ISSUES AND RECOMMENDATIONS**

- ***Bilateral Agreements with International Institutions on Dual Taxation Avoidance***

### **ISSUE**

International bilateral agreements on dual taxation avoidance, the agreements on social insurance, as well as on the accession of BiH to international institutions, such as the World bank, International Financial Corporation, European Bank for Reconstruction and Development, and other institutions, are not publicly available, nor is there any single registry/central database in which all agreements inherited, signed by SFRY, and agreements/contracts signed and/or ratified by BiH could be found. Only the Agreement signed with Albania is available at the web portal of the BiH Ministry of Foreign Trade and Economic Relations<sup>7</sup>.

Tax problems also originate from current regulations pertaining to the manner and terms of residence and stay of foreign citizens (in the territory of FBiH). Foreign investors' institutions frequently appoint an owners' representative as manager. For such persons, it is impossible to regulate the employment-legal status on the basis of current Agreements on mutual recognition of social insurance rights, should such acts exist in the first place.

Tax on natural persons' total annual income is lacking a definition in its provisions. In FBiH, this issue is frequently left up to cantonal legislation, which again leaves a lot of room for disputes.

<sup>7</sup> [http://www.mvteo.gov.ba/home/index.php?option=com\\_content&task=section&id=7&Itemid=39](http://www.mvteo.gov.ba/home/index.php?option=com_content&task=section&id=7&Itemid=39)

## **RECOMMENDATION:**

BH Ministry of Foreign Affairs and BH Ministry of Treasury and Finance should publish all the valid agreements on dual taxation entered into by BiH (Croatia, Montenegro, Pakistan, Serbia, Slovenia, United Arab Emirates), or inherited by it as the legal successor of ex SFRY (Belgium, Czech Republic, Cyprus, Denmark, Finland, France, Great Britain, Hungary, Italy, Norway, Sweden, Slovakia), as well as agreements with other countries, adopted but still not ratified, or those still in the process of adoption (Austria, the new agreement with Czech Republic, Greece, Jordan, Malaysia).

All bilateral agreements should be filed in the registry of agreements, publicly available to all taxpayers, i.e. the texts of all agreements should be posted on internet pages of the state Ministry of Foreign Affairs, and the Ministry of Finance and Treasury of BiH. Institutions competent for the agreement registry and interpretation thereof should be, respectively, the Ministry of Foreign Affairs or the ministry of Finance and Treasury. In Croatia, these agreements are also published by the Ministry of Finance, respectively, by the Tax Administration, and also by the Ministry of Foreign Affairs.

Interpretation of agreements should be provided by the Ministry of Finance and Treasury of BiH, and these should be aligned with interpretations and positive taxation practice of the OECD countries, since the majority of current dual taxation agreements constitute standardized OECD international agreements on dual taxation.

With respect to dual taxation, the tax reform should definitely move in the direction of avoiding thereof, and mutual recognition of social insurance payments.

- **Corporate Income Tax**
  - **Dual Taxation**

## **ISSUE**

Under RS laws, a taxpayer with the principal place of business in FBiH or BD should pay tax on profit realized in RS. Such tax is recognized as a deductible under the new Corporate Income Tax Law in FBiH. However, a taxpayer with principal place of business in RS, with operations in BD and FBiH, should, under RS laws, pay the tax in RS on total profit of the company, regardless of the fact that it needs to pay the tax in BD too on profit realized from operations in BD. Respectively, the tax paid in BD cannot be offset against tax liability in RS.

The Income Tax Law in BD does not fully and clearly prescribe the method for avoiding dual taxation within BiH, i.e. the possibility for the taxpayer with principal place of business in BD and income realized in RS and FBiH, subject to corporate income tax laws in RS and FBiH, to use that tax as a deductible from total tax liability calculated in line with the BD law.

The new Corporate Income Tax Law in FBiH has the best solution for the issue of dual taxation within BiH. Namely, under this Law, a taxpayer with principal place of business in RS or BD, which operates in FBiH too, is not a corporate tax taxpayer in FBiH. In case of a taxpayer with principal place of business in FBiH operating in RS and BD, and paying the tax under current laws, such tax can be used as a deductible for tax liability in FBiH.

**RECOMMENDATION**

Should RS and BD laws be harmonized with the Corporate Income Tax Law of FBiH, the dual taxation issue would be resolved permanently, and in the simplest possible way as far as the taxpayer is concerned – only one tax return as per the location of the principal place of business of the taxpayer.

- ***Dividends, Capital Gain Withholding Tax***

**ISSUE**

Dividends paid to a non-resident in FBiH are taxable at the rate of 5%, while in RS and BD they are not taxable. Interest paid to a non-resident is taxable at the rate of 10% (with the exception of interest paid for procurement of equipment and goods, and deposit interest), while in RS the interest paid to a non-resident is not taxable in all cases as in FBiH and in the case of interest paid to all loans issued by foreign banks, while the law in BD has no withholding instrument at all.

The Corporate Income Tax Law in RS provides for 10% withholding tax for capital gain realized by non-resident legal person through sale of stock or share held in a resident company in RS. The FBiH Law does not provide for taxation of capital gain, if realized by non-resident company through sale of property (shares or immovable property) in FBiH.

**RECOMMENDATION**

Taxation of dividends and capital gain needs to be harmonized for RS and FBiH for the purpose of creation of a single economic space.

- ***Tax Treatment of General and Special Provisioning with Banks in FBiH***

The FBiH Corporate Income Tax Law<sup>8</sup> or the Article 16 of the Rulebook<sup>9</sup> nowhere mentions Bank provisioning in line with the International Accounting Standards or special regulations. Article 16 of the Law is not elaborated under the Rulebook, and the interpretation thereof needs to be provided in order to allow this as an allowable expenditure – special provisions for loan losses appropriated by banks in line with the Decisions of the Banking Agency of the Federation of BiH.

In addition, Article 14 of the Rulebook states that bad and disputed receivables are recognized as an allowable expenditure in the tax balance, in case the taxpayer has fulfilled or undertaken at least one measure as prescribed under Article 14 of the Law. Since the banks classify assets, in line with the Decisions of the Agency, depending on the day of delinquency for payment of due liabilities (and depending on other elements serving as loan security), into categories A, B, C, D, E, and calculate provisioning in line with prescribed percentages, then reserves should carry into costs over several years, with full costing when the loan category E, 100% reserved.

In the context of the above stated and the Article 14 of the Law, it is unclear whether the reserve should be recognized as an expenditure only in the year in which it is classified as E, at 100%, or whether the cost should be spread over the period of step-by-step downgrading and reserving.

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<sup>8</sup> Official Gazette of FBiH 97/07 and 14/08

<sup>9</sup> Rulebook on Application of the Corporate Income Tax Law



**RECOMMENDATION:**

An interpretation should be provided for Article 16 of the Law in order to recognize this category as an allowable expenditure – special provisioning for credit losses, appropriated by banks in line with the Decisions of the Banking Agency of FBiH. At the same time, the recognition of special provisioning needs to be regulated, i.e. provisioning appropriated in line with international accounting standards and special regulations of the Federal Banking Agency, and stated in the Account of gains and losses in line with the Nett principle (cost/abolished cost). Recognition of general provisioning in line with Nett principle (cost/abolished cost), 20% of gain stated in the Account of gains and losses. An interpretation is required for the application of Article 14 of the Law and the Rulebook.

- ***The Issue of Calendar vs. Business Year***

**ISSUE**

On a positive note, RS introduced a possibility for the tax year to differ from the calendar year, which is a common tax-wise practice in EU countries. The Laws in FBiH and BD provide no such possibility.

**RECOMMENDATION**

A tax year different from a calendar year would be much more acceptable and normal for taxpayers engaged in so-called seasonal activities, i.e. those realizing the majority of their income in the period different from tax payment periods under current laws (end of March of current year for previous year). Introducing a tax year different from a calendar year in the FBiH and Brcko District would be a positively accepted practice, and would at the same time harmonize the approach throughout the country.

In addition, the tax return filing period of 90 days, following the end of tax year, is a very short one and should be extended to at least 120 or even 180 days.

• **BRCKO DISTRICT:**

- ***Income Tax (Personal/Corporate)***

**ISSUE**

The Income Tax law is a single Law governing the taxation of income of natural and legal persons. In Brcko District (BD), the income of legal persons is taxed under the cash accounting principle, i.e. the subject of taxation is the positive difference between collected income and paid expenditures, with reconciliation of depreciation costs and the so called default interest. This Law is in complete disharmony with the relevant Laws in RS and FBiH.

**RECOMMENDATION**

In order to secure ease of doing business for companies, Brcko District authorities should adopt two entirely different laws as was done by the two Entities, as follows:

- **Corporate Income Tax Law** which will be applicable only to legal persons, i.e. their business units, and which will at least be harmonized with the new corporate income tax laws of the entities, and
- **Personal Income Tax Law** which will be applicable to entrepreneurs/tradesmen and citizens.

- **Accounting Standards**

**ISSUE**

The BiH Accounting Law is in effect in Brcko District, and it obliges all taxpayers to prepare financial reports in line with the International Accounting Standards and the International Financial Reporting Standards, i.e. in line with the accrual method of accounting, not the cash accounting method. This is not consistent with the BD Income Tax Law, which does not categorize accounting revenues and expenditures, nor reserves for potential losses, nor administrative costs paid at the principal place of business of the company (RS or FBiH).

**RECOMMENDATION**

Having in mind the specifics of the Income Tax Law in BD, the District tax authorities should issue an instruction for taxpayers with principal place of business in the RS and FBiH (and for those with principal place of business in BD), on how to properly calculate tax liabilities, i.e. how to complete the tax return.

In issuing of this regulation, special attention should be paid to taxpayers with principal place of business outside of BD, i.e. those who file tax returns only for the profit realized in BD: whether to include a portion of shared costs, which taxpayers pay in line with the principal place of business (administration, management, bookkeeping, licences...), how provisions for risks and potential losses are recognized as tax expenditures, which depreciation rates are acceptable tax-wise, etc.

- **Real Estate Taxation**

**ISSUE**

In line with the current legislation in BiH, real estate under construction is taxed twice, by the Indirect Taxation Administration and by municipal tax bodies.

The state VAT Law defines that only the initial sale of real estate is subject to VAT, while any subsequent sales are not. Such provisions deprive many companies of deduction for input VAT when purchasing real estate for a business activity, in the case when such transaction is not the first transaction. Such provisions lead to non-competitiveness of leasing companies when offering financial and operational leasing for real estate in BiH market.

The Law on Sales Tax of Real Estate and Rights is defined differently by the Entities and Cantons. In the RS, the sales tax on real estate and rights charges 3% for real estate under construction, and then the seller's invoice charges the VAT too for the respective real estate. In FBiH, Cantons apply different tax rates for sales of real estate, ranging between 5% and 8%. Respectively, in FBiH, there are 10 different cantonal level laws on real estate sales tax, which apart from different rates also have different taxation principles. In Sarajevo Canton, the initial sale of real estate is not taxable when it is sold by a legal entity, while in other cantons (Zenica-Doboj Canton, Orasje, Tuzla Canton, Central Bosnia Canton), such sale is taxable. In some cantons, contributing real estate as initial capital in an enterprise, paid in kind, is not subject to taxation (Hercegovina-Neretva Canton, Unsko-Sanski Canton, Tuzla Canton...), while in others it is (Sarajevo Canton, Posavina, Central Bosnia Canton...). Certain companies in Sarajevo and Zenica-Doboj Cantons, apart from sales price with VAT, also have to pay 5% to 8% sales tax on real estate.

## **RECOMMENDATION**

One of proposals to enable simpler sales of new real estate, which is subject to VAT, is to apply a similar method as in neighboring countries, where sale of real estate is subject to VAT computation, as long as such sale is made between persons operating within VAT system (legal persons).

Such VAT computation would work for the benefit of parties involved in sales process and of the state, since VAT would be paid for each sale, for which the legal person purchasing the real estate is entitled to refund, and the budget would be filled more regularly.

- ***VAT Filing and Refund***

## **ISSUE**

Legal obligation for VAT tax return filing in BiH is until the 10<sup>th</sup> of the month for the previous month. This deadline is quite short from the taxpayer's view, especially for companies that operate throughout the country.

It would be more practical for taxpayers to have a longer period, in order to have time to enter all the incoming invoices, and for the sake of reduction of tax liability itself. At the same time, VAT obligation pertaining to regular annual inventory, as of December 31, is a workload which can hardly be completed by January 10, and the extension of the deadline would also provide for less omissions in completion of VAT returns.

In addition, it is a frequent occurrence that refunds to companies are not running in line with VAT filing dynamics. Frequently, companies receive money for the previous month, whereas they still have not received it for the months before that.

## **RECOMMENDATION**

The legal deadline for tax return filing should be pushed from the 10<sup>th</sup> to 15<sup>th</sup> of the month, and VAT payment deadline should be 7 days from the deadline for filing of the return.

It would be good to build into the VAT legislation the filing of annual VAT return in order to enable the taxpayers to include into this annual return all the corrections of monthly returns for the given year, which constitutes a simpler solution for the taxpayer and for the tax administration. (The current legal solution implies the filing of an amended VAT return for each change, amendment, or correction to the previously filed monthly VAT returns.)

*Summary of Recommendations*

**TAXES**

• **Legislation:**

- Corporate Income Tax
  - Harmonization of law between the entities and Brcko District, enabling submission of only one tax return as per the location of the principal place of business of the taxpayer.
  - Harmonization of taxation of dividends and capital gain between RS and FBiH
  - The legal deadline for tax return filing should be pushed from the 10<sup>th</sup> to 15<sup>th</sup> of the month, and VAT payment deadline should be 7 days from the deadline for filing of the return.
- Brcko District
  - Introduction of two separate laws: Corporate Income Tax Law and Personal Income Tax Law that will be harmonized with entities laws

• **Practical Aspects:**

- Publish all bilateral tax agreements on respective websites of the BiH Ministry of Foreign Trade and Economic Relations and the Ministry of Treasury and Finance
- Amend and extend bilateral tax agreements with all relevant countries to avoid double taxation and regulate mutual recognition of social insurance payments and rights
- Having in mind the specifics of the Income Tax Law in BD, the District tax authorities should issue an instruction for taxpayers with the principal place of business in RS and FBiH (and for those with principal place of business in BD), on how to properly calculate tax liabilities, i.e. how to complete the tax return.
- To enable simpler sales of new real estate, which is subject to VAT, make sale of real estate subject to VAT computation, as long as such sale is made between persons operating within VAT system (legal persons).

## 4.4 CONSTRUCTION PERMITS

The process of obtaining all approvals and permits for the construction of a facility in a city zone is complex and extremely lengthy. The process includes about 80 different activities, including coordination within various institutions and it takes on average from 10 to 14 months.

Table 8

<b>Construction Permits</b>	
<p><b>Strengths:</b></p> <ul style="list-style-type: none"> <li>In comparison with neighboring countries, BiH has fewer procedures</li> </ul> <p><b>Key Governance Institutions:</b></p> <p><b>Entity level:</b></p> <ul style="list-style-type: none"> <li>Ministry of spatial planning, construction and ecology (RS)</li> <li>Ministry of spatial planning (FBiH)</li> <li>Ministry of Agriculture, Water-Management and Forestry (FBiH)</li> <li>Ministry of Environment and Tourism (FBiH)</li> <li>Various institutions (Road Directorate, etc...)</li> </ul> <p><b>Cantonal level:</b></p> <ul style="list-style-type: none"> <li>Respective ministries</li> <li>Institute for planning</li> <li>Institute for construction</li> <li>Municipality authorities</li> <li>Public enterprises:               <ul style="list-style-type: none"> <li>Elektroprivreda</li> <li>Vodovod i kanalizacija</li> <li>PTT komunikacije</li> <li>Komunalni otpad</li> <li>Komunalno grijanje</li> <li>Snabdijevanje gasom</li> <li>Zastita kulturno-istorijskog i prirodnog naslijeđa</li> <li>Sanitarna inspekcija</li> </ul> </li> </ul>	<p><b>Weaknesses:</b></p> <ul style="list-style-type: none"> <li>Lack of spatial, urban and regulatory plans</li> <li>Deadlines defined by laws are not met by authorities</li> <li>No central place where all information can be obtained nor handbook with respective regulations (laws, bylaws, etc...) that define the procedure</li> <li>An updated land registry does not exist</li> <li>Extremely complex procedure for splitting land designated for construction</li> <li>Lack of coordination among authorized institutions</li> <li>Lack of planning and organizational skills of authorized departments</li> <li>Inconsistency of steps within the overall procedure</li> </ul>

The key obstacles that companies face in obtaining construction permits are related to the complexity of the process, the lack of centralized information, and inefficiency and lack of support by administrative and managerial personnel to investors. The inadequate approach by competent institutions often jeopardizes the implementation of investor projects. Indirectly, taxes are reduced, and creation of new jobs as well as municipal development is delayed or lost.

In FBiH there is overlapping jurisdiction and scope of responsibilities among institutions that issue approvals / permits for construction projects. Often there is lack of coordination and communication among authorized institutions, and investors suffer the consequences.

In order to introduce best practices in the field of spatial, urban and regulatory planning, install information technology, streamline procedures, and increase efficiency, some BiH municipalities have initiated pilot projects or cooperated with international organizations. In some municipalities the process has been dramatically improved. As one example, in Banja Luka, in 2005 to get urban – technical approval document required several months, and now the same document can be obtained in couple of hours<sup>10</sup>. Certain regulatory changes are in process. For example, instead of having to obtain the “urban approval” in advance of the building permit, new legislation proposes a single location information. Such legislative changes will significantly reduce the number of days required to obtain required construction permits. A prerequisite for getting location information is the existence of spatial and regulatory plans.

## **SURVEY: ISSUES AND RECOMMENDATIONS**

- **Lack of Spatial, Urban and Regulatory Plans**

### **ISSUE**

The majority of municipalities in BiH do not have documented spatial, urban or regulatory plans. Even to obtain information about which municipalities in FBiH that have developed spatial plan is quite hard – there is no single institution that has such information on the entity level. The FBiH Ministry of Spatial Planning will direct you to the competent Cantonal Ministry. At the level of FBiH the Law on spatial planning and land use is in force.

In September 2007, the RS government adopted a master spatial plan for Republika Srpska that is valid till 2015. All municipalities located in RS are obliged to adjust their spatial plans in accordance with this master spatial plan. Out of 63 municipalities in RS, more than 50% do not have spatial plans. It is expected that a new Law on the Organization of Space and Construction will be adopted soon.

### **RECOMMENDATION**

Establish an electronic database with the status of spatial, urban and regulatory plans for all municipalities/cities in the country. Create a publication where information on available land/space and purpose of facilities are presented.

- **Complex Procedure**

### **ISSUE**

An investor is obliged to obtain three types of documents in order to build a business – the urban approval, the construction (building) permit, and usage permits. All these documents are obtained sequentially. According to research undertaken by USAID SPIRA project in 2007-08 it takes on average 430 days to obtain all three documents.

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<sup>10</sup> USAID Governance Accountability Project

As shown in the table, according to the experiences of businessmen and municipal authorities there are significant differences in the number of days required to process all three types of permits. Even if we accept information provided by municipal authorities as objective, it still takes on average five months for officials to issue each document.

Table 9  
Average Time to Secure Construction Related Permit

Permit	Mean (survey)*	Mean (municipal records)*	Difference (%): survey versus records	mean of means
Urban approval	277	114	143	196
Construction permit	119	111	7	115
Use permit	140	102	37	121
<b>Total</b>	<b>536</b>	<b>327</b>	<b>64</b>	<b>432</b>

Source: USAID SPIRA An SME perspective of Public Services The Survey Report June 2008, \*excluding statistical outliers

In case it is necessary to revise spatial, urban or regulatory municipal plans, or if land ownership must be clarified, the number of days required to get all permits will be considerably longer. Often ownership information for cadastral plots is not registered at Land Registry, and much time is needed to correct the land registry and to obtain valid ZKK document.

If a building plot is not technically prepared for immediate kickoff of construction works – i.e., if existing facilities have to be removed, electricity supply ensured, water pipes relocated, etc. – additional approvals for each of these actions are required from the competent institution.

Urban approval and construction permit are valid for one year. If the investor is unable to start building within that time frame – which may easily be the case if additional approvals and permits are required – then the construction permit must be applied for all over again.

Below are listed all institutions involved in the process of getting construction related permits and documents. In Sarajevo Canton, for instance, if the facility covers area over 5,000 m<sup>2</sup>, a request for urban planning must be submitted to the cantonal ministry, and up to 5,000 m<sup>2</sup> to respective municipality.

Chart 5 Required Documents for Urban Approval, Construction and Use Permits

Required documents for Urban Approval		Required documents for Construction Permit		Required documents for Use Permit	
INSTITUTION	DOCUMENT	INSTITUTION	DOCUMENT	INSTITUTION	DOCUMENT
Municipality	Request	Municipality	Request	Municipality	Request
Municipality	Cadastre report	Municipality	Urban approval	Municipality	Request
Court	Land registry report	Municipality	Cadastre report	Municipality	Permit
Investor	Project design	Investor	Proof of the right to build		
Cantonal Ministry	Environment permit	Investor	Project design		
		Cantonal Ministry	Environmental permit		
		Road Directorate	General consent		
		Elektro distribucija	General consent		
		Vodovod i kanalizacija	General consent		
		PTT	General consent		
		Komunalno	General consent		
		Toplane	General consent		
		Snadbjevanje gasom	General consent		
		Zastita kulturno-istorijskog i prirodnog naslijeda	General consent		
		Institut zaštite na radu	Permit		
		Institut zaštite od požara	Permit		
		Sanitarna inspekcija	Permit		

### **Interrelations**

If respective institution does not issue certain permit within legally defined timeframe e.g. construction permit, consequently implementation of the project will be delayed. Officials' inefficiency will damage investor, financial institution and society as a whole. Delay will cause: (i) additional expenses for investor, (ii) jeopardize project implementation, (iii) late payments of loan by investor, (iv) additional risk for financial institution (v) job creation will be postponed, (vi) lower taxes income for governmental institutions.

Information on laws, bylaws, procedures, and institutions involved in the overall process, as well as contact information related to approvals and permits, cannot be found at the web portals of municipalities, cantons or entities. Even if certain municipality have made the effort to post a request form on their website, the form is not adjusted to fit smaller projects undertaken by citizens and large scale projects undertaken by businesses. Some municipalities have posted information on issued urban approvals, but information on the date when a request has been received, processed and approved is not provided. However, practices vary widely from authority to authority.

## **RECOMMENDATIONS**

**Create a handbook** – A handbook for businesses should be created along with roadmap for obtaining all approvals and permission, with respective legislation, forms and institutions involved in the overall process.

**Introduce priority system** – Develop a system where officials will sort incoming requests according to the following criteria, and divide organizational functions within permitting authorities accordingly:

- Civil or private sector
- Project value
- Priority (if needed introduce VIP treatment )

**Introduce a new service** or nominate officers who will provide all possible support to investors – full services from a day one when a request is submitted, through project implementation, coordinate activities with other departments till the project is completed.

**Technical preparation of a building plot** - Prior to tender announcement, competent institutions should prepare all respective documents, building plot and secure preconditions for immediate start of construction activities or at least provide all possible support to investor in the overall process.

**Build managerial and technical capacities within the courts.**

**Accelerate the updating of land registries.**



- ***Disrespect of Legally Binding Deadlines and Lack of Coordination Among Various Institutions***

**ISSUE**

According to the Law on Administrative Procedure, documents should be processed by officials within 30 days. In practice this is not the case.

If some claim against investor is filed at court, due to inefficient judiciary processes, an investor’s project can be significantly delayed, or even completely blocked. Construction activities to a large extent depend on the weather conditions, and activities are intensified over the summer months. Due to inefficiency of competent institutions, permissions and approvals are issued with a certain delay. Such delays shorten the construction season, implementation of projects is jeopardized, and additional financial expenses incurred.

**RECOMMENDATION**

Officials should respect legal deadlines. Financial incentives should be introduced for officials who process incoming requests on time.

Entity, cantonal and municipal officials should improve communication, exchange of information and cooperation in order to improve customer services for citizens and the private sector.

*Summary of Recommendations*

**CONSTRUCTION**

**Practical Aspects:**

- Create a database with information on a status of spatial, urban and regulatory plans for all municipalities
- A handbook for businesses should be created along with roadmap for obtaining all approvals and permissions, with respective legislation, forms, and institutions involved in the overall process.
- Develop a priority system where officials will sort all incoming request according to the following criteria, and functionally reorganize accordingly:
  - Civil or private sector
  - Project value
  - Priority (if needed introduce VIP treatment)
- Use of information technology and GIS systems at the state level in order to reduce paper work and improve processes

**Human Resources Management:**

- Enhance capabilities of officials in order to improve customer service for citizens and businesses



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Raiffeisen Bank

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## **8. ANNEXES**



## **8.1 ANNEX A**

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