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Investment in Bosnia and Herzegovina

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Preface

Investment in Bosnia and Herzegovina is one of a series of booklets published by KPMG to provide in-depth and specific information on individual countries to those considering investing or doing business there. This publication has been prepared by KPMG in Bosnia and Herzegovina.

Every care has been taken to ensure that the information presented herein is correct and accurate as at 31 August 2010. The reader, however, should be aware that most of the statistical information presented was available, as of, typically, earlier dates only. The publication's purpose is to provide the reader with general information on investing and/or doing business in Bosnia and Herzegovina. Therefore, before taking specific decisions, specific advice should be sought.

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Glossary

BiH	Bosnia and Herzegovina
CPT	Corporate Profit Tax
DTT	Double Tax Treaty
Entities	Both the FBiH and the RS
Entity	Either the FBiH or the RS
EU	European Union
FBiH	Federation of Bosnia and Herzegovina
ILO	International Labour Organisation
OHHR	Office of the High Representative
PIT	Personal Income Tax
RS	Republic of Srpska
SAA	Stabilisation and Association Agreement
SEE	South East Europe
SFRY	Socialist Federal Republic of Yugoslavia
S/s c	Social security contributions
VAT	Value Added Tax
WHT	Withholding Tax
WTO	World Trade Organisation

Chapter 1

General Information

1.1 Geography and Climate

BiH is a mountainous country located in the heart of SEE, in the western part of the Balkan Peninsula. Its territory covers 51,209 sq kilometres (19,741 sq miles), of which 51,197 sq km is land and 12.2 sq km sea. The interior of the country is mountainous with the Dinaric Alps dominating the landscape. The northern and eastern parts are heavily forested, while the south has flatter areas of fertile soil. Topographically, more than 75% of the country lies less than 1,500 m above sea level. The lowest point is the Adriatic Sea (0 m) in the south, and the highest point is Maglic (2,386 m) in the south east.

BiH shares borders with Croatia to the north and west, Serbia in the east and Montenegro in the southeast. It has a short Adriatic coastline of approximately 23 kilometres (14.3 miles) in the south-west (with no ports).

Waters in BiH hydrographically belong to the Black Sea Basin (76% of BiH's total surface area) and to the Adriatic Sea Basin (24% of BiH's total surface area). The principal rivers include the Sava, which forms the country's border in the north and is the recipient of water streams which belong to the Black Sea basin, the Una which contributes to the western border and the Drina, contributing to the eastern border. Principal rivers also include the Neretva, the only major river that flows south into the Adriatic Sea, and the Sava's tributaries, the Una and the Vrbas.

For the most part BiH has a continental climate with cold, snowy winters and hot summers, except in the southern part where a Mediterranean climate prevails. Areas of high elevation have short, cool summers and long, severe winters.

1.2 Historical Background

BiH formed part of the Ottoman Empire from 1463 to 1878, during which period many of its inhabitants converted to Islam. From 1878 to 1918 BiH formed part of the Austro-Hungarian Empire. After the end of the First World War, BiH became part of the Kingdom of Serbs, Croats and Slovenes from 1918 to 1929, which was succeeded by the Kingdom of Yugoslavia from 1929 to 1941.

After the end of the Second World War, BiH became part of the Federal People's Republic of Yugoslavia from 1946 to 1963 which was succeeded by the Socialist Federal Republic of Yugoslavia ("SFRY").

The SFRY disintegrated in 1991, with armed conflict mainly in the territories of Croatia and BiH, which ended in 1995. As of 2010, the successor states to the SFRY, in addition to BiH, comprise the Republics of: Slovenia, Croatia, Serbia, Montenegro, Macedonia

(officially known as the Former Yugoslav Republic of Macedonia) and Kosovo. Owing to their shared history and other factors such as linguistic similarities, these states form a natural market for each other with a total estimated population of some 23 million.

1.2.1 The Independent State of Bosnia and Herzegovina

BiH declared independence in March 1992. The state of BiH retained its territories and borders (which it had as a constituent republic of the SFRY) under the Dayton Agreement signed in December 1995, which established BiH as a multi-ethnic state with a constitution at the level of BiH, as well as a separate constitution for each of its two Entities – the FBiH and the RS. The FBiH comprises 51% and the RS 49% of the territory of BiH.

The Brcko area of BiH was not initially awarded to either of the two Entities. On 8 March 2000, as a result of International Arbitration, a third jurisdiction – the Brcko District – was created within BiH, as a self-governing administrative unit under the sovereignty of BiH and formally held in condominium between the FBiH and the RS and under international supervision. The Brcko District covers an area of 493 sq kilometres and has a population of approximately 79 thousand.

The FBiH is administratively divided into ten Cantons, which are in turn subdivided into a total of 79 municipalities. The RS is more centralised, it has no cantons and is directly constituted of 62 municipalities.

1.3 Population and Language

According to the 1991 census, BiH had a population of 4.4 million, of which 43% were Bosniak (Bosnian Muslims), 31% were Serbs, 17% Croats, 6% Yugoslavs, and the remaining 2% consisted of people of other ethnic origin. The population density was 86 persons per sq km.

The war in the 1990s caused large population migrations: it is estimated that 2.2 million people were moved from their pre-war homes. However, no census has been taken since 1991. Given its determination to continue its progress towards the EU, BiH is now planning to take part in the pan-European census in 2011.

Currently the population of BiH is estimated to be between 3.8 million¹ and 4.6 million². Based on an estimate from 2000³, 48% of the population are Bosniaks⁴, 37.1% Serbs, 14.3% Croats and the remaining 0.6% represents other ethnic groups. There is a strong correlation between ethnic identity and religion: Muslims constitute 45% of the population, Serb Orthodox 36%, Roman Catholics 15%, and other religious groups constitute 4%⁵.

1 According to the estimation of the Agency for Statistics of Bosnia and Herzegovina

2 According to the CIA Factbook

3 CIA Factbook

4 Term "Bosniak" is commonly used to describe Muslims as an ethnic group, in order to avoid confusion with the religious term Muslim – an adherent of Islam.

5 International Religious Freedom Report 2008

Sarajevo, with an estimated population of 393 thousand (June 2008) is the capital of BiH and the FBiH. Banja Luka is the administrative centre of the RS (population of 164 thousand). Sarajevo and Banja Luka are followed in size by three other cities in the FBiH: Tuzla (84 thousand), Zenica (83 thousand) and Mostar (67 thousand).

The official languages are Bosnian, Croatian and Serbian (all of which were formerly known as Serbo-Croat, and are now commonly referred to as "local languages"), but English and German are also commonly used in business. The Latin alphabet is commonly used. Cyrillic is also an official alphabet.

1.4 Infrastructure

In 1991 BiH had 21,168 km of roadways, 52% of which were paved, and 1,000 km of railway track, of which 75% was electrified. The country's infrastructure was heavily damaged in the 1990s, when about 35% of the roadways and 40% of bridges were destroyed, and the damage to the rail system was estimated at USD 1 billion.

The post-war period has been characterised by reconstruction, and according to post-war figures, BiH has 21,846 km of roadways (52% paved) and 1,021 km of railway track (78% electrified).

The largest development project in post-war BiH is the construction of a road corridor, which is part of the Trans-European Network. The Vc corridor goes through the central part of BiH, on a north-south route, along the rivers Bosna and Neretva. The total length of the corridor is 335 km, of which 85% is in the FBiH, and the remaining 15% is in the RS. The estimated construction costs amount to EUR 4 billion. As at the date of this publication, about 60 km of the Vc corridor through BiH has been constructed.

In terms of waterways, the Sava river with its ports Bosanska Gradiska, Brod, Samac and Brcko, is open to shipping but its use is limited due to unresolved issues with neighbouring countries. BiH has 8 airports with paved runways, 4 of which are international (Sarajevo, Banja Luka, Tuzla and Mostar). Sarajevo International Airport is the largest airport, with an annual capacity of 800 thousand passengers. The national airline, BH Airlines, operates regular connections to 8 European countries.

Postal services are provided by three companies, each providing exclusive services in regions characterised by a different ethnic majority: BH Post and Croatian Post (in the FBiH) and RS Post (in the RS). Similarly, land line telecommunication networks are operated by BH Telecom and Croatian Telecommunications (in the FBiH) and Telekom Srpske (in the RS), which are also providers of mobile phone services. In 2008 there were 1.031 million land lines in use, and 3.179 million mobile phone users. Contrary to the telephone land line services, mobile phone services are not limited to the region where the provider is registered and users are able to choose their preferred service provider. The international country code for BiH is 387.

The Internet infrastructure is rapidly developing, and in July 2010 there were 79 licensed Internet providers. The number of Internet users has been increasing and in 2010 is estimated at 31.2% of the population (2000: 0.2%, 2007: 20.3%). BiH's Internet domain is ".ba".

1.5 Labour Force

The BiH labour force is relatively highly skilled and educated. More than three-quarters of the labour force has completed secondary schooling (technical or vocational) or further education (Phd level inclusive). Foreign investment has brought know-how and technology into the country, thus increasing the productivity of the labour force.

Based on a 2009 survey, the labour force was estimated at 1.132 million (44% of the working age population). In 2009 21.2% of employees were employed in agriculture, 31.5% in industry and 47.3% in services.

The unemployment rate is relatively high when compared to the EU average (in 2009 the estimated annual unemployment rate was 24.1% according to the ILO definition). The grey economy significantly affects all sectors of the BiH economy and the high unemployment rate also reflects in the consequent underreported employment. Wages still lag behind those of Western Europe. The average net wage in 2009 was BAM 789 (approximately EUR 400) per month.

1.6 The Political System

BiH is a parliamentary democracy with a bicameral parliament (House of Representatives and House of Peoples), Council of Ministers and a Constitutional Court.

The state-level House of Representatives has 42 seats, 28 for representatives from the FBiH and 14 seats for RS representatives, elected by popular vote on the basis of proportional representation. The last elections were held in 2006, and the next general elections are to be held in October 2010.

The state-level House of Peoples has 15 seats, 5 for each of the main ethnic groups, which are elected from the FBiH's House of Peoples (Bosniaks and Croats) and from the RS's National Assembly (Serbs). The next composition of the House of Peoples is to be constituted in 2011.

The Head of state is the Chairman of the three-member Presidency. The three members of the Presidency come from each of the three main ethnic groups and they rotate the position of Chairman on an 8-month basis. They are elected by popular vote for a four-year term, and the next elections are to be held in October 2010.

The Council of Ministers is body of executive authority of BiH. It comprises a Chairman and 9 Ministers. The Chairman is one principal appointed by the Presidency, after the approval of the House of Representatives. The Chairman appoints the Council of Ministers, also subject to the approval of the House of Representatives.

The Constitutional Court consists of nine members. Six judges are selected by the respective assemblies or parliaments of the Entities (four members are selected by the FBiH House of Representatives; two members are selected by the RS National Assembly). The remaining three judges are appointed by the President of the European Court of Human Rights after consultation with the Presidency of BiH.

The Court of BiH was formally established in 2002 as a body ensuring the protection of fundamental human rights and freedoms at the state level, as guaranteed by the Constitution of BiH. It consists of 54 judges, 48 national and 6 international judges, and

it has three divisions – Administrative, Appellate and Criminal. The Entities each have a Supreme Court and a number of lower courts.

The highest political authority in BiH is the OHR, which is the chief civilian peace implementation agency in BiH. It is led by the High Representative, who is also the EU's Special Representative in BiH. The Dayton Peace Agreement designated the High Representative to oversee the implementation of the civilian aspects of the Peace Agreement on behalf of the international community. The High Representative is also tasked with co-coordinating the activities of the civilian organisations and agencies operating in BiH.

1.6.1 Entities

Both the FBiH and the RS have a bicameral legislature that consists of a House of Peoples and a House of Representatives in the FBiH, and a National Assembly and a Council of Peoples in the RS. In addition, in the FBiH there are 10 Cantonal Assemblies. Both the FBiH and the RS each have a President.

The Brcko District is organised as a state district with local self-government.

1.7 International Memberships

BiH became an official member of the United National (UN) in May 1992, of the Council of Europe (C of E) in April 2002 while an application for membership of the World Trade Organisation (WTO) was submitted in May 1999 and is still in process. In addition, BiH is a member of the following organisations (the list is not exhaustive):

- The International Monetary Fund (IMF);
- The International Bank for Reconstruction and Development (IBRD);
- The European Bank for Reconstruction and Development (EBRD);
- The International Financial Corporation (IFC);
- The International Development Association (IDA);
- The International Maritime Organization (IMO);
- The Food and Agriculture Organization of the United Nations (FAO);
- The International Organization for Standardization (ISO);
- The International Criminal Police Organisation (Interpol);
- The Central European Free Trade Agreement (CEFTA);
- Group 77 at the United Nations;
- United Nations Conference on Trade and Development (UNCTAD)

BiH is a potential candidate country for EU accession following the Thessaloniki European Council of June 2003. On 16 June 2008 the EU and BiH signed a Stabilisation and Association Agreement (SAA) which will enter into force once its ratification process has been completed. An Interim Agreement on Trade and Trade-Related

Issues, entered into force on 1 July 2008. The European Commission launched a visa liberalisation dialogue with BiH on 26 May 2008, which is still underway.

1.8 The Economy

Basic economic indicators are presented in the table below.

	2007	2008	2009	Source
Gross Domestic Product (GDP) in million BAM	21,760	24,702	23,950	Bilten 4 2009, Bilten 1 2010 CBBH
GDP in million EUR	11,126	12,630	12,245	Bilten 4 2009, Bilten 1 2010 CBBH
GDP per capita in '000s EUR	5.7	6.4	6.2	Bilten 4 2009, Bilten 1 2010 CBBH
GDP year on year rate of growth (%)	6.0	5.4	-3.4	CIA factbook
Average year on year inflation rate (%)	8.2	1.6	7.3	www.indexmundi.com
Current account balance in million (US\$)	-1.9	-2.7	-1.4	www.indexmundi.com
Current account balance as % of GDP	-12.6	-14.9	-7.5	www.economywatch.com, IMF
Export of goods and services as % of GDP	38.9	36.8	Not published yet	The World Bank
Import of goods and services as % of GDP	73.3	69.5	Not published yet	The World Bank
External debt in million EUR	2,025	2,167	2,677	CBBH, Bilteni
Gross international reserves in million EUR	3,425	3,219	3,176	CBBH, Bilteni
Average gross monthly salary in EUR	348	401	411	CBBH, Bilteni
Unemployment rate (persons 15 to 64 years) %	29	23.4	24.1	Agency for Statistics of Bosnia and Herzegovina
Average exchange rate (BAM : 1 EUR)	1.95583	1.95583	1.95583	CBBH

Chapter 2

Foreign Investment in BiH

The BiH Act on Foreign Investment specifies that foreign investors have the same rights and obligations as domestic investors when investing in BiH.

2.1 Foundation of New Companies or Acquisition of Shares in Existing Companies by Foreign Investors

Foreign individuals and legal entities may found new companies or acquire shares in existing companies in BiH. Companies that are wholly or partly foreign owned can generally operate in all business areas. Where the chosen activity requires a permit (e.g. banking, insurance) the same rules apply regardless of whether the owners are domestic or foreign investors.

2.2 Returns Payable to Foreign Investors

There are no legal restrictions on the payment of returns on investments (e.g. dividends, interest) to foreign shareholders. This provides important protection to foreign investors. However, dividends and interest are generally subject to withholding tax. The tax system and current tax rates are discussed in the separate taxation chapter.

2.3 Branches and Representative Offices

Branch offices and representative offices are not separate legal entities but an organisational unit of their founder.

Branch offices can be registered in BiH only by local legal entities (regardless of whether the local company is established by foreign or local capital). In other words a foreign legal entity cannot establish a branch office in BiH. Companies established in the FBiH may establish branch offices in the RS under RS legislation. The relevant legislation in the FBiH similarly allows companies established in the RS to establish branch offices in the FBiH. Consideration needs to be given to the various separate and combined reporting requirements for statutory reporting purposes, tax purposes and regulatory reporting purposes, where relevant.

A foreign company may establish a representative office in BiH. Representative offices can be established for market research, promotion and to obtain business information for the founder; they must be non-profitable and are not permitted to generate

income. Representative offices are relatively easy to administer, and their activities can be stopped immediately without consequence. In addition, in the FBiH wages of individuals employed by a representative office are subject only to employee's social security contributions at the rate of 31% (please refer to the separate chapter on taxation for further details).

2.4 Commercial Company

The various forms of commercial companies are set out in Chapter 3 – Commercial Companies in BiH.

Chapter 3

Commercial Companies in BiH

The legislation governing the establishment, operation, management and termination of commercial companies in BiH is set at the Entity level. Our comments apply to both Entities, unless it is specifically stated otherwise.

Under the Entities' legal systems the following types of business association are generally available:

- Joint-stock Company (d.d.)
- Limited Liability Company (d.o.o.)
- Limited Partnership (k.d.)
- Unlimited Joint Liability Company (d.n.o.) – only the FBiH
- Unlimited Partnership (o.d.) – only the RS

Please note that whereas the FBiH legislation recognises an Unlimited Joint Liability Company, its RS counterpart identifies an Unlimited Partnership as a form of business association. The most important factor that separates a d.n.o., o.d. and k.d. from a d.d. and d.o.o. is that the members of a d.n.o., o.d. and at least one member of a k.d. have unlimited liability for the entity's debts while liability of the members (shareholders) of a d.d. and d.o.o. is liability limited to the amount of their share capital. Another important difference is that the establishment, operation, management and termination of a d.n.o., o.d. and k.d. is considerably less formalised.

In practice, most foreign investors are likely to form or take a financial interest in either a limited liability company (d.o.o.) or a joint-stock company (d.d.).

Generally, the procedure of establishing a business operation in BiH takes on average 1-2 months.

The basic costs include:

- Administrative costs: approximately EUR 500
- Legal costs: EUR 500 – 1,000.

Note that costs differ between the Entities.

3.1 General Rules Applicable to all Commercial Companies

3.1.1 “Pre-company” Status

An initial step in founding a business venture is the preparation of written Articles of Incorporation, which must be signed by all members (or their authorised representatives bearing power of attorney). A notary public must countersign this document.

Alongside the Articles of Incorporation, in the RS an unlimited partnership and limited partnership may have a partners’ agreement, while a limited liability company may have a members’ agreement. Apart from the Articles of Incorporation, a joint-stock company may have a Statute.

In the FBiH a limited liability company and a joint-stock company must, alongside the Articles of Incorporation, have a Statute.

The Commercial Companies Law prescribes that a company assumes the capacity of a legal entity when it is registered in the Municipal Court Register and the Commercial Court Register, in the FBiH and the RS respectively.

3.1.2 Registration

All companies are required to be registered with the Municipal Court Register in the FBiH and the Commercial Court Register in the RS. The location of the seat of the company being registered determines which court has jurisdiction.

The data that needs to be recorded in the Register includes:

- MBS – “matični broj subjekta” (the company’s registration number as issued by the relevant court);
- Name of the company;
- Registered official seat of the company;
- The scope of the company’s business activities;
- Authorised signatory(ies); and
- The company’s form (d.d., d.o.o., etc.).

3.1.3 Statutory Audit

According to the Entities’ Laws on Accounting and Auditing, the financial statements and consolidated financial statements of companies classified as medium and large are subject to a statutory audit. The financial statements of companies registered as joint-stock companies and companies seeking to list on a regulated market of securities have a mandatory audit requirement. Other specific laws in BiH may also prescribe an obligation for certain types of businesses to be subject to a mandatory audit. Companies classified as small can decide to have an audit in accordance with the provisions of the Laws on Accounting and Auditing.

For more detailed information on the audit and financial reporting requirements for commercial companies please refer to Chapter 5 of this publication.

3.1.4 Termination of Business Association

A company is terminated when it loses its legal personality, i.e. upon the termination being registered in the relevant Court Register.

A company shall terminate:

- If the period of time set forth in its Articles of Incorporation expires;
- If it resolves its termination with legal successors (transformation – merger, demerger),
- If it resolves its termination without a legal successor (liquidation);
- Upon being declared terminated by the relevant court; and
- Under certain other conditions.

3.2 Joint-stock Company (“d.d.”)

A joint-stock company, or a company limited by shares, is registered in the Municipal Court Register and the Commercial Court Register, in the FBiH and the RS respectively, and may be established by one or more physical persons or legal entities.

A joint-stock company has share capital which is divided into shares.

In the FBiH and the RS a joint-stock company may be a private joint-stock company or a public joint-stock company. In general, public joint-stock companies are those whose shares are traded on a regulated market, whereas the shares of private joint-stock companies are issued to shareholders based on a non-public emission of shares.

The minimum amount of initial share capital required to establish a joint-stock company in the FBiH is BAM 50,000 (approximately EUR 25,565), with the nominal value per a share in the amount of no less than BAM 10 (approximately EUR 5.11).

The minimum amount of initial share capital required to establish a private joint-stock company in the RS is BAM 20,000 (approximately EUR 10,225), as opposed to BAM 50,000 (approximately EUR 25,565) required to establish a public joint-stock company. In the RS, the nominal value of a share must satisfy the following:

- The minimum nominal value of one share must not be less than BAM 1 (approximately EUR 0.51); or
- Must be divisible by 10.

Shareholders of a joint-stock company are not personally liable for the obligations of the company.

Share Capital

Generally, shares can be either ordinary or preference shares. Ordinary shares provide their holder with the following rights:

- The right to participate and vote at the general assembly meetings (one share – one vote);

- The right to receive dividends, after dividends relating to preference shares have been paid; and
- A claim on the net assets of the joint stock company in case of liquidation, after payments relating to debentures and preference shares have been made.

Rights carried by preference shares particularly relate to priority over ordinary shares in dividend payments (which may be cumulative) and priority payment in the instance of liquidation. If general preference shares do not carry any voting rights, but provided certain conditions are met, these can assume voting rights.

General Assembly

The supreme body of a joint-stock company is the general assembly, which comprises of its shareholders.

Powers which fall within the authority of the general assembly, among others, include:

- Distribution of profit;
- Decision on coverage of losses;
- Approval of the Annual Report;
- Appointment and dismissal of the independent auditor, internal auditor and audit committee;
- Amendments to the joint-stock company's Statute;
- Decision to increase or reduce the share capital;
- Decision to change the form of or dissolve the company;
- Other powers which relate to operations of a joint-stock company and which are defined in the Commercial Company Law and the Statute.

The general assembly must be convened at least once a year (the Annual General Meeting) and as frequently as required in the Statute. If necessary, extraordinary general meetings may be held at any time during the year.

In the FBiH the general assembly is usually convened by the supervisory board. However, should the supervisory board fail to convene the shareholders assembly, the assembly can be convened by a shareholder holding more than 10% of shares with voting rights, a member of the supervisory board, or a member of the audit committee. Decisions of the general assembly are made by simple majority of votes. A qualified majority of votes is required in special cases or may be required by the Statute.

In the RS the general meeting is most commonly convened by the management board, but can also be convened upon the request from one third of the management board's members or other persons authorised by the Statute, the liquidator (when the company is in liquidation) and shareholders holding more than 10% of shares with voting rights, or the decisions of the general assembly are adopted by simple majority of votes. A qualified majority is required by law for special cases or may be required by the Statute.

Supervisory Board and Audit Committee

In the FBiH the supervisory board is elected by the general assembly, which is also authorised to dismiss it. The supervisory board consists of at least three members. The number of the members must be odd.

The supervisory board supervises the management of the company and is, among other things, authorised to convene the general assembly, appoint and oversee the management and approve asset transactions in the range of 15% to 33% of the company's total asset value.

An audit committee must be formed in a joint-stock company.

The RS Commercial Companies Law does not recognise a supervisory board, but only recognises the internal audit function and the audit committee as supervisory bodies. Namely, it states that the Statute of a private joint-stock company may determine to have an internal audit function and an audit committee and that the Statute of a public joint-stock company must determine to have an internal audit function and an audit committee.

Management and Management Board

The management organises the work, manages and represents a joint-stock company and is responsible for the legality of its business operations.

In the FBiH the supervisory board appoints the management, comprising of a director or a director and one or more executive directors as prescribed by the Statute. The formal structure of a management board is not envisaged in the legislation

The mandate of a director is four years with the possibility of re-appointment. If the management also consists of executive directors, who are appointed for the same period as the director.

In the RS in the case of a private joint stock company the general assembly may appoint a director or a management board. In the case of a public joint stock company, the appointment of a management board is mandatory. A management board may have between three and fifteen members. Members of the management board must elect among themselves the president of the management board who has the capacity of a general director. In general, the management board is responsible for development of business strategy, implementation thereof, management of the company, supervision of executive directors and administration of the company. In the case of a public joint stock company the management board must appoint an executive board comprising of executive directors. In the case of a private joint stock company the appointment of an executive board is optional. An executive board is responsible for implementing the decisions of the management board as well as of managing ongoing business activities. The general director presides over the executive board.

In the FBiH the director, and in the RS the director or the general director and the management board, are responsible for the financial reports in accordance with the relevant accounting regulations, which should then be submitted to the supervisory board in the FBiH and the general assembly of the shareholders in the RS.

Increase of Share Capital

The two Entities to some extent differ in the recognition of means by which the share capital may be increased. Hence, the share capital of a joint stock company in the FBiH may be increased:

- By the issue of new shares;
- By the issue of shares to employees from the company's profit; or
- From reserves.

In the RS, the share capital may be increased:

- By the issue of new shares;
- By the conversion of convertible bonds; or
- From reserves.

Reduction of Share Capital

A reduction of the share capital of a joint stock company in the FBiH is conducted in the following order:

- Redemption of shares;
- Decrease of the nominal value of shares;
- Reimbursement and redemption of the remaining shares; and
- Renouncement from the issue of partly paid up shares.

In addition, the capital can be decreased through a transfer to reserves for the purpose of covering the business losses.

In the RS, the share capital of a joint-stock company may be decreased:

- Through a regular decrease of share capital (decrease of the nominal value of the shares or reimbursement of partly paid up shares) ; or
- Through a simplified decrease of share capital (i.e. in cases of losses); or
- Through a transfer to reserves (for the purpose of covering business losses)..

3.3 Limited Liability Company (“d.o.o.”)

A limited liability company is a popular form of association for small and medium-sized commercial companies in BiH. It is possible to establish a single-owner limited liability company. In practice, limited liability companies are the most common company form for wholly-owned subsidiaries.

A limited liability company is registered in the Municipal Court Register and the Commercial Court Register in the FBiH and the RS respectively. The minimum share capital required to establish a limited liability company is BAM 2,000 (approximately EUR 1,023).

Share Capital

Members of a limited liability company are not personally liable for the obligations of the limited liability company.

In the FBiH the minimum ownership stake in a limited liability company is set at BAM 100 (approximately EUR 51.1). The RS does not specify the minimum ownership stake that a member can have.

The share capital of a limited liability company is comprised of the capital contributions of the individual members, which can be contributions in cash and in kind, provided that at least BAM 2,000 is contributed in cash (approximately EUR 1,023 is contributed in cash).

Members of a limited liability company assume ownership which is proportionate to the value of their stakes in the company.

The Articles of Incorporation (or Deed of Foundation) must include the amount of share capital and the stake value of each individual member.

Assembly

The supreme body of a limited liability company is the assembly, which comprises the company's members. The assembly has a quorum if representatives of at least half of the registered share capital are present, unless the Articles of Incorporation stipulate otherwise.

A simple majority of votes cast is required to adopt the assembly's decisions, unless determined otherwise by the Articles of Incorporation.

Amongst other matters, the following falls within the domain of the assembly:

- Approval of the financial reports of the limited liability company and use of profits;
- Election and removal of a director or the members of the management and the determination of their remuneration;
- Appointment and removal of the company's external auditor, validation of the auditor's findings and opinions, establishment of the auditor's remuneration and other terms of business with the company;
- Increase and reduction of share capital;
- Change of legal form or decision on termination of the company;
- Amendments to the Articles of Incorporation; and
- Other matters as prescribed by the Articles of Incorporation.

Supervisory Board

Generally, limited liability companies require lower standards of corporate governance than joint stock companies.

For example, in the FBiH there is no requirement for a supervisory board to be elected.

However, a supervisory board is mandatory for a limited liability company which has more than ten members and a limited liability company which has share capital exceeding BAM 1 million (approximately EUR 511 thousand).

In the RS, a supervisory body is not a recognised body of a limited liability company. Even though it is not mandatory, in both Entities a limited liability company may choose to have an internal audit function and an audit committee as a form of best business practice.

Managing Director(s)

The administration of the company's affairs and representation of the company is carried out its management, led by the managing director (or directors). The management is appointed by the members of the company. Any physical person (i.e. a BiH national or a foreign national) capable of entering into legal transactions, who has not been convicted for business crimes or misdemeanours as prescribed by BiH legislation, can be a member of the management.

The management prepares financial reports in accordance with the relevant BiH accounting regulations. The annual financial report and report on the state of the company should then be submitted to the assembly and the supervisory board (if applicable).

Increase and reduction of share capital

The share capital of a limited liability company may be increased:

- Through new payments or contributions in kind; and
- Through a nominal capital increase (capitalisation of reserves or gains of the company).

The share capital of a limited liability company may be decreased but not below the statutory minimum amount for the registered share capital of a limited liability company, i.e. BAM 2,000 (approximately EUR 1,023).

The share capital is increased or reduced by a decision of the assembly of a limited liability company.

Chapter 4

Working in BiH

4.1 Working Permission

As a general rule foreign persons cannot usually be employed in BiH unless they hold a valid work permit and a residence permit.

Work permit: A foreign person intending to work in BiH must obtain a work permit. Activities relating to the foundation of a new legal entity are not considered as work and are not subject to a work permit.

An application for a work permit is submitted by the employer to the relevant local Labour Centre. A work permit must be obtained prior to applying for a residence permit. A work permit is issued for a specific position, for a maximum period of up to one year, in accordance with the determined annual work permit quota. The annual quota of work permits is determined by the Government and it includes the number of work permits that can be extended and the number of new work permits for each year.

In certain cases, including those noted below, a work permit can be issued irrespective of the annual quota:

- Foreign person with a university degree or higher;
- Foreign person whose work in BiH is based on an international agreement;
- Foreign person who performs key activities in a local legal entity.

An employee may begin to work in BiH only after having received all the necessary permits.

Certain categories of foreign nationals do not require a work permit to work in BiH if certain conditions are met. Such categories include:

- Members of a Supervisory Board;
- Founders of a local legal entity;
- University professors and scientists;
- Foreign journalists;
- Artists and supporting staff (e.g. for theatres, concerts).

Residence permit: A residence permit can be temporary and permanent.

A temporary residence permit is issued to foreign persons for various reasons, which include marriage with a BiH national, consultancy work, engagement in the management of a company or employment in accordance with a working permit.

A temporary residence permit is issued for a period of up to one year. A request for a temporary residence permit must be supported by a valid work permit (in case of employment), proof that the foreign person is a key person in management or is in an executive position (in case of the engagement in the management of a company) or proof that the foreign person has the expertise required for the business activities of a local legal entity. Note that a local employment contract cannot be concluded without a valid residence permit.

Permanent residence will be granted to a foreign person who has had a continuous temporary residence permit in BiH for a period of at least five years.

4.2 Employment Law

Legislation governing employment in BiH is levied at the level of the Entities. Our comments below apply to both the FBiH and the RS, unless explicitly stated otherwise.

The basic elements of employment agreements are regulated by the FBiH Labour Law and the RS Labour Law.

The Labour Laws provide a basis for organised labour negotiations with trade unions or other representative bodies of employees, and together with the General Collective Agreements of the Entities, they provide for the basic rules of employment. General Collective Agreements of the Entities are applicable to all employers in the relevant Entity. However, more than one collective agreement may have effect on the employer (e.g. collective agreements of industrial sectors or Cantons (FBiH only), if any). The Labour Laws and the collective bargaining agreements of the Entities will prevail over any contradictory provisions of the employment agreement, with the exception that any provision more beneficial to the employee than the corresponding provisions of the Labour Laws will prevail.

The main stipulations of the Labour Laws are as follows:

Employment agreement: An employment agreement should be concluded in writing, but in the FBiH it may be in oral form, provided that the employer provides the employee with a written statement consisting of all of the mandatory elements of an employment agreement within the prescribed period of time. The employment agreement must be in line with the stipulations of the Labour Law of the relevant Entity.

Working hours: Full time working hours must not exceed forty hours per week, inclusive of a half-hour break daily (in the RS only, in the FBiH the half-hour daily break is not included in full time working hours).

Minimum wage: In both Entities the minimum wage is determined by the Entity's Government in accordance with the relevant General Collective Agreement. In the FBiH the Government determines the minimum hourly rate which is currently set at BAM 2.97 gross (BAM 2.05 net). The minimum monthly net salary in the RS prescribed by

a decision of the RS Government is set at BAM 370 (except for the textile industry, for which the minimum net monthly salary is BAM 320).

Holidays: Employees are entitled to a minimum of 18 days paid leave per annum.

Period of employment: Generally, an employment agreement is concluded for an indefinite period. Exceptionally, an employment agreement may be concluded for a definite period under conditions regulated by the relevant Labour Law.

Termination of an employment agreement: The Labour Law differentiates between:

- regular termination, which includes redundancy termination, dismissal based on personal reasons and dismissal based on misconduct; and
- summary termination, where either the employer or the employee may terminate the employment agreement without the right to a regulated or contracted notice period due to extremely severe violations of employment obligations.

Severance/redundancy: Where an employer ceases to require the skills of an employee, the employee may be made redundant. Termination payments are obligatory for employees with more than two years' service with the employer and are calculated as at least one third of one average month's salary paid to the employee in the past three months for each full year of employment worked with that employer.

Chapter 5

Accounting and Auditing

BiH accounting regulations are set out at the level of the Entities.

5.1 Accounting Principles

Accounting and reporting frameworks applicable in the Entities of BiH are defined by the relevant Entities' Laws on Accounting and Auditing. The Accounting Laws require that financial statements for all companies are prepared for each financial year based on International Financial Reporting Standards (IFRS).

A financial year is usually equal to the calendar year. However, a period different from the calendar year may be used by reporting entities, provided a formal approval by the relevant Entity's Ministry of Finance is obtained.

Regulatory supervision for operational conduct, financial and other reporting and legal issues for banking institutions, microcredit and leasing institutions is performed by the Entities' Banking Agencies which issue regulations, including accounting-related regulations, which are legally binding for those entities. Insurance companies are supervised by the BiH Insurance Agency and by the relevant agencies of the Entities.

The Entities' Ministries of Finance, which are responsible for accounting and auditing regulations, are also responsible for direct taxation, and corporate liability to taxation is still closely dependant on the recording of financial transactions in accordance with the accounting rules.

Company bookkeepers are usually focused on booking accounting transactions in the way expected by the tax authorities and on being provided with the supporting documentation which a tax authority inspector may be expected to request.

Classification of Companies

The financial reporting and disclosure requirements depend on whether a company is classified as a small, medium or large entrepreneur.

A company may be classified as:

- Small, if the size of operations does not exceed any two of the following criteria, as at 31 December of the period preceding the period for which the classification is determined:
 - 1 Average number of employees in a year less than 50 employees;
 - 2 Total assets up to BAM 1 million; and
 - 3 Turnover up to BAM 2 million.

- Medium, if the size of operations meets any of two of the following criteria, or if it exceeds the upper limit of at least one of the following criteria, as at 31 December of the period preceding the period for which the classification is determined:
 - 1 Average number of employees in a year between 50 and 250;
 - 2 Total assets between BAM 1 million and BAM 4 million; and
 - 3 Turnover between BAM 2 million and BAM 8 million.
- Large, if the size of operations exceeds the upper limit of any two of the criteria for classification as a medium company, as at 31 December of the period preceding the period for which the classification is determined.

All financial services industry entities (including banks, microcredit organisations, insurance companies, leasing companies, investment fund management companies and obligatory and voluntary pension fund management companies, stock exchanges and other financial companies) are deemed large due to the nature of their business.

Accounting and Bookkeeping

The relevant Entities' Laws prescribe, amongst other matters, the following:

- Accounting records which must be kept in accordance with the principles and rules laid down in the relevant Law.
- This requirement does not preclude the use of accounting and reporting systems developed and/or held outside BiH. However, such systems must be capable of presenting accounting information in accordance with the Law and the prime ledgers and accounting documents must be made available promptly in BiH if requested for Tax Authorities' inspections.
- The accounting records must be kept in a local language and in BAM.
- The Accounting Laws define the minimum ledger system to be kept by all reporting entities, which is to include a general ledger, sub-ledgers and a journal (including journal entries). The general ledger must be kept for a minimum period of eleven years in the FBiH and ten years in the RS, whereas sub-ledgers must be kept for a minimum of seven years in the FBiH and five years in the RS. Payroll lists and documents proving ownership over real estate and shares are kept permanently.
- The financial year is the calendar year. However, subsidiaries of foreign legal entities whose financial year differs from the calendar can present their financial statements for a period different than a calendar year, subject to a prior approval of the relevant Entity's Ministry of Finance.

Auditing

Companies required to have an annual statutory audit are:

- all entities registered as joint stock companies and entities seeking to list on an organised market of securities;
- all companies classified as middle and large;

- companies that need to file consolidated financial statements;
- financial statements of companies subject to *lex specialis* for a specific industry (e.g. banks, insurance companies, leasing companies and similar).

Audits of financial statements are based on International Standards of Auditing, and a statutory audit may only be performed by an eligible and authorised auditing firm which is licensed by the Ministry of Finance of the relevant Entity. Audit companies licensed in one BiH Entity are eligible to obtain licences in the other Entity on the basis of mutual recognition of qualifications.

Only certified auditors of the Entity, registered with the Entity's Association of Auditors and Accountants, qualified in accordance with the relevant Law, actively employed with a registered auditing company or engaged by the auditing company, are allowed to sign audit opinions.

Audit companies must keep the audit supporting documentation for at least seven years in the FBiH and five years in the RS.

Audit firms are required to obtain professional indemnity insurance.

Audit firms cannot provide the services listed below to a company during the financial year for which an annual statutory audit is being performed:

- Finance and accounting services;
- Valuation services;
- Actuarial services;
- Services related to internal audit;
- Managerial services and HR services (the FBiH only);
- Legal and professional services in relation to the audit process;
- Consultancy, broker-dealer or investment services
- Other services provision of which would result in conflict of interest (the RS only).

The same audit company is permitted to perform five consecutive financial statements audits, after which rotation rules apply. Exceptionally, another two consecutive financial statements audits are allowed, provided that the audit is performed by another certified auditor. Please note that legislation regulating particular industries may prescribe more strict rotation rules.

Financial Reporting Deadlines

Large and medium companies are required to prepare financial statements for each financial year, comprising a balance sheet, income statement, statement of changes in equity, cash flow statement and notes to the financial statements. Companies classified as small prepare financial statements comprising a balance sheet and an income statement. In addition, all companies are required to submit reports prepared according to the requests of the relevant Entity's Statistics Office. Other reporting obligations might be imposed by *lex specialis* for the specific industry.

Large and medium size companies, as well as those listed on the stock exchange or entities that are seeking to be listed, are required to prepare half-year financial statements consisting of a balance sheet, income statement, cash flow, statement of changes in equity and notes to the financial statements.

Annual financial statements of the previous year must be submitted to the relevant institutions by the end of February of the current year. Half-year financial statements for the current year are submitted by 31 July of the current year. Consolidated financial statements are submitted by 30 April in FBiH and by 31 March in the RS of the current year for the previous year.

Chapter 6

Taxation

Introduction

BiH's tax system is complex due to the administrative organisation of the country. At the turn of the century, the two Entities had completely separated tax systems which often resulted in double taxation within the country.

A first step in a long process of tax reform was the introduction of a single indirect tax system at the state level, i.e. at the level of BiH. Reform of the indirect tax system was completed in 2006 when VAT was introduced.

Direct taxes remain at the level of the Entities, and after reforms in the period from 2007 – 2009 legislation applicable in the two Entities is harmonised to a certain extent.

Currently, the significant taxes and levies imposed in BiH are:

- At the State Level:
 - VAT
 - Customs Duties
 - Excise Duties
- At the Level of the Entities:
 - Corporate Profit Tax
 - Personal Income Tax
 - Social Security Contributions

The following taxes are levied at the level of Cantons in the FBiH and at the Entity level in the RS:

- Gift and Inheritance Tax
- Real Estate Transfer Tax
- Property Tax

In our comments below we provide an overview of taxes and duties applicable at the State level and at the level of Entities, without commenting on laws which are in the FBiH levied at the level of Cantons.

Our comments below apply to both Entities, unless specifically stated otherwise.

6.1 Indirect Taxes

6.1.1 VAT

VAT was introduced on 1 January 2006 with its most recent amendment effective as of May 2010.

VAT is payable on all supplies of goods and performance of services in BiH.

Entrepreneurs and legal entities performing business activities are obliged to register for VAT purposes if they had taxable supplies in excess of BAM 50,000 in the previous year. This applies to foreign entities performing VATable supplies in BiH, which are obliged to appoint a VAT representative in BiH.

VAT is payable at the standard rate of 17% on the supply of goods (which include products, commodities, real estate (excluding land), equipment and other) and the performance of services, personal consumption and the import of goods in BiH.

Exports are zero rated. This includes export of goods and manufactured goods, including transport and all delivery services, the delivery of goods to tax-free sales outlets and specialised warehouses, the delivery of goods and the provision of services to diplomatic missions under the condition of reciprocity.

The following activities are VAT exempt in BiH:

- Activities in the public interest (e.g. hospitals, etc.);
- Financial and monetary services;
- Importation of goods (special cases).

Invoices for goods delivered or services rendered must indicate the amount of VAT as a separate item. Further, for goods or services that are exempt or zero rated their status must be clearly indicated on the invoice.

VAT is accounted for monthly via VAT monthly returns and payment of any resulting VAT liability is due by the 10th day of the following month.

Services are taxable in BiH if they are deemed to be supplied in BiH. Generally, services are deemed to be supplied in BiH if the provider of services is a BiH VAT payer.

Exceptions to the above rule include the following:

- If the performed services are in relation to real estate, including rental and lease, the place of the performance of service is considered to be the location of the real estate;
- In relation to transport, the place of the performance of the service is considered to be each leg of the journey, applicable for domestic legs of the journey only;
- The place where the services were actually performed in relation to:
 1. artistic, scientific, educational, sport, entertainment or similar services and the organization of the same;

2. ancillary transportation services, such as: loading, unloading, storage and other transport related services;
 3. services performed on movable assets, expert opinions, appraisal and evaluation of the same.
- In relation to intermediary services, the place of performance of services is considered to be the place of delivery of goods or services performed in relation to the intermediation.

However, the following services are not subject to VAT in BiH, if provided by a BiH VAT payer to a foreign entity (i.e. services are VATable according to the residence of the recipient):

- Transfer, cession, or use of authorship rights, patents, licences, registered trademarks and similar rights or the waiver of such rights;
- Advertising services;
- Services provided by engineers, lawyers, auditors, accountants, translators and other similar services;
- Electronic data processing services;
- Banking, financial services and insurance services;
- Secondment of employees;
- Rental of movable property, excluding vehicles; and
- All mediation with regards to the above services.

If a BiH VAT payer purchases the above services from abroad, such services are subject to the reverse charge mechanism.

The VAT base is normally the total sum paid or payable to the supplier of the goods or services, including all taxes, commissions, costs and charges whatsoever. VAT on imports is charged on the customs value of the goods increased by the amount of customs duty and any other charges and special taxes payable on the import of the goods.

A VAT liability generally arises at the point when one of the following activities is performed, whichever is the earliest:

- 1 Supply of goods or performance of services;
- 2 Issuing of an invoice; or
- 3 Receipt of payment or partial payment before an invoice is issued.

A taxpayer is entitled to recover input VAT paid on the purchase of goods or services, from another taxpayer, or on the importation of goods or services, provided that he or she uses those goods or services for supplies subject to VAT.

A taxpayer may exercise the right to recover input VAT incurred in the course of the supply of goods abroad or the performance of services, on condition that the right to recover input VAT would have existed if such a supply had been performed in BiH.

A taxpayer is entitled to recover input VAT only if:

- The taxpayer is registered for VAT;
- Goods or services are purchased from another registered VAT taxpayer, or imported;
- Goods or services are purchased or imported for the purpose of performing business activities; and
- Goods or services are purchased or imported for performing other taxable supplies.

A taxpayer may not exercise the right to recover input VAT on the following:

- 1 Purchases used to perform VAT exempt supplies;
- 2 Purchases used to supply goods and services abroad if, for that supply, the taxpayer would not have the right to recover input VAT had it been performed in BiH;
- 3 Supply of goods and services purchased from a BiH resident who is not a registered VAT taxpayer.

Further, input VAT is specifically disallowed on the following purchases/expenses:

- 1 Purchase, production and importation of personal cars, buses, motorcycles, vessels and aircraft and any spare parts for such means of transport, fuels and consumable materials for transportation purposes, as well as renting, maintenance, repairs and other services related to the use of these means of transport, unless they use the means of transport and other goods exclusively for carrying out their business activity;
- 2 Expenses for entertainment and accommodation.

Construction projects whose value exceeds BAM 25 thousand are subject to a special VAT scheme in which the constructor pays the VAT invoiced to the constructor by the subcontractor directly to the Indirect Tax Administration, and only after that is the contractor entitled to recognise it as input VAT.

6.1.2 Customs Duties

Customs duties are regulated by the Customs Policy Law, the Customs Tariff Law, and other regulations.

BiH tariff codes are based on the standard international classification system and on the European Union tariff codes.

The Customs Policy Law recognises the following customs procedures:

- Transit;
- Customs warehousing;

- Inward processing;
- Processing under customs supervision;
- Temporary admission;
- Outward processing;
- Export;
- Free zones and warehouses;
- Re-export; and
- Destruction under supervision.

Customs duty is payable on:

- Goods imported into BiH – liability arises on the day the goods are put into free circulation or on the day the goods are temporarily admitted;
- Goods exported from BiH – liability arises on the day the goods are taken out of the BiH customs area.

In determining the value of the goods, all costs and other expenses related to the sale and delivery of goods to the place of entry into the BiH customs area are taken into account, including:

- Transport costs;
- Insurance costs;
- Agent’s commission;
- Packaging costs; and
- Loading and reloading costs.

All costs, fees and administrative taxes collected in the customs area of BiH are excluded from the customs base.

Exemptions

There are number of exemptions from customs duties; such exemptions are stipulated in the “Enclosure on goods exempt from the payment of customs duties”, which forms a part of the Customs Policy Law, and which, subject to certain conditions and monetary limits, include:

- Relief on the basis of international conventions;
- Goods contained in travellers’ personal luggage;
- Personal belongings of physical persons relocating to BiH;
- Inherited personal belongings;

- Fixed assets and other equipment in relation to the transfer of business activities to BiH;
- Promotional samples insignificant in value;
- Articles imported for humanitarian purposes;
- Goods for organisations and associations of handicapped persons; and
- Others stipulated by the above-mentioned regulation.

Customs Duty Rates

The Customs Tariff sets out the rates of customs duty applicable to imported products. BiH uses compound duties consisting of two parts: ad valorem (%) and specific (BAM per quantity unit). The latter is used only for certain agricultural and food products.

The Customs Policy Law has been amended on several occasions since it came into effect on 1 January 2005.

The customs duty rates, as prescribed in the Customs Tariff Law and the Customs Tariff, are applicable for all countries. There are reduced customs duty rates for imports and exports with Croatia, Macedonia, Moldova, Montenegro, Serbia and Turkey.

Temporary Imports and Exports

It is possible for goods to be “temporarily” imported into the BiH customs area for use, provided that such goods are intended for re-export and have not been subject to any change except from the decrease in value due to use. The goods must be temporarily imported with a defined purpose and with the obligation of being returned within a certain period of time. The Customs Policy Law defines the method and time-limits in respect of temporary imports.

The customs relief can be in full or partial. Temporary import with partial conditional relief means that for each month that the goods are created as such, 3% of the customs duty and taxes otherwise payable upon import are charged.

Outward processing permits for goods to be “temporarily” exported from the BiH customs area in order to undergo processing and goods made by such processing are put into free circulation with full or partial import customs relief. “Temporary” export of goods from the BiH customs area includes export duty charges.

Import and Export Restrictions

There are restrictions in regards to the import and export of certain goods, such as commercial goods, narcotics, poisons and other dangerous substances, weapons, ammunition, explosives, materials with a harmful content, antiques, artworks of historic and other interest, etc.

6.1.3 Excise Duties

On 1 July 2009 the new Law on Excise Duties came into effect. Excise duties are levied on a limited number of products either imported into BiH or manufactured in BiH. Therefore, tax payers for excise duty purposes are importers or producers.

Excise duties are levied on the following products:

- Oil and oil derivatives;
- Alcohol, alcoholic drinks and natural brandy;
- Beverages and soft drinks;
- Beer and wine;
- Tobacco and tobacco by-products; and
- Coffee and coffee by-products.

6.2 Direct Taxes

Direct taxes are levied at the level of Entities. Our comments below apply to both Entities, unless otherwise is specifically stated.

6.2.1 Corporate Profit Tax (CPT)

The basic principles for the taxation of business profits are detailed in the respective Entities' CPT Laws and CPT Regulations.

Both Entities have reformed their CPT systems. The RS introduced a new CPT Law as of 1 January 2007, with the most recent amendments to the Regulations effective as of 29 January 2009. The FBiH introduced a new CPT Law as of 1 January 2008, with the most recent amendments to the Law itself effective as of 17 June 2009.

Taxable persons with an obligation to pay CPT in the FBiH/the RS are as follows:

- A company or other legal or physical person resident in the relevant Entity, who is permanently and independently engaged in an economic activity for the purpose of realising profit.
- A resident permanent establishment (an inland business unit) of a non-resident entrepreneur. Under the corporate legislation and related practices in the FBiH and the RS foreign businesses may not register branch offices in either Entity. As a result, we have not observed any permanent establishments (envisaged under the CPT legislation of both entities) being registered for CPT purposes either in the FBiH or in the RS.
- Although the bodies listed below are generally exempt from CPT, they may be subject to CPT for economic activities carried out whereby the non-taxation of these activities would result in an unfair tax advantage. The bodies are:

- the Central Bank of BiH;
- state administration bodies;
- bodies of regional and local self government;
- state and regional and local self government institutions and institutes;
- foundations;
- religious communities, political parties, trade unions, chambers, associations, unions, and civil organisations;
- artists' associations and volunteer fire companies;
- tourist boards and sports clubs.

Tax Period and CPT Returns

CPT is calculated for the period of a calendar year. However, the RS Ministry of Finance may allow for the calendar and business years to differ upon the request of the RS taxpayer, in case of a subsidiary unit of a foreign legal company. A CPT return must be submitted to the relevant office of the Tax Administration by 30 March (FBiH), or 31 March (RS) following the relevant calendar year.

The taxable period is different from the business year, if in the business year the entity becomes a taxpayer or ceases to be a taxpayer (including statutory changes).

CPT taxpayers pay monthly advance payments, based on the previous year's CPT return. Any CPT shortfalls at the year-end must be self-assessed and paid by the taxpayer.

CPT Base Determination

In the FBiH the CPT base is the accounting profit adjusted for non-deductible and non-taxable items in accordance with the provisions of the FBiH CPT legislation. Accounting profit is the difference between revenues and expenditures, calculated in accordance with the official accounting framework in the FBiH, i.e. IFRS based. In the RS the taxable base is determined as the difference between taxable revenues and tax deductible expenditures as determined in accordance with the RS CPT legislation.

The CPT base must be increased by the following (the list is not exhaustive):

- The amount of depreciation in excess of the prescribed amount;
- 70% of entertainment expenses specifically related to business activities, otherwise 100% of entertainment expenses;
- Penalties for overdue taxes or other duties;
- Penalties for breaches of laws;
- Withholding tax paid on the burden of the taxpayer (in the RS withholding tax paid on the burden of a RS taxpayer, on the income generated by a foreign legal entity for services provided in relation to property that the RS taxpayer uses for generating taxable revenues is tax deductible for the RS taxpayer);

- Losses realised in transactions between related parties;
- Donation expenses exceeding 3% of realised revenues in the tax period (in the RS it is possible to carry forward donations exceeding 3% of realised revenues over the next three years);
- Donations to political parties;
- Membership fees to commercial and similar chambers exceeding 0.1% of realised revenues in the tax period (excluding membership fees for chambers, participation in which is mandatory);
- Sponsorship expenses exceeding 2% of realised revenues in the tax period;
- Scholarships to students exceeding 75% of average net monthly salary in the RS according to the latest published statistics (RS only);
- The cost of reserves, other than those specifically allowed by the CPT legislation;
- Write-offs of receivables where certain conditions have not been met;
- Transfer prices different from market values which decrease the tax base.

The CPT base must be decreased by the following (the list is not exhaustive):

- Dividends and profit shares;
- Revenues from written-off outstanding debts which were included in the taxable base in previous periods and were not deducted as an expense;
- Research and development expenditure.

All CPT payers in both Entities are entitled additionally to decrease the CPT base for 100% of expenditure for research and development. The provisions of the FBiH CPT Law are vague and do not provide for further details on this subject, whereas the RS legislation defines what is considered as expenditure for research and development.

Tax Losses

Tax losses can be carried forward and set off against future profits reducing the tax base within the following five years, using the first-in-first-out method.

Tax losses cannot be carried back to earlier periods.

Foreign Tax Credit

A credit system is used to avoid double taxation on income received from abroad. The credit for tax paid abroad may not exceed the amount of tax due in BiH on the foreign income.

Groups/Consolidation

Tax consolidation is available in both Entities.

In the FBiH tax consolidation is available to resident FBiH taxpayers provided that there is a direct or indirect control over at least 90% of shares. Once approved by the FBiH Tax Administration, tax consolidation is applied for at least 5 years.

The condition for tax consolidation in the RS is ownership of at least 80% of shares with voting rights or 80% of the total value of shares in the subsidiary, or if a maximum of 5 individuals directly or indirectly (through related individuals) owns at least 80% of shares with voting rights in companies which are subject to tax consolidation.

Withholding Tax (“WHT”)

The standard WHT rate applicable in the FBiH and the RS is 10%. A reduced 5% WHT rate is applied on dividends paid abroad by the FBiH taxpayers. The RS does not levy WHT on dividend payments (subject to a 10% participation rule).

WHT is calculated on the gross amount of consideration paid by a resident payer to a non-resident payer for qualifying interest, intellectual property rights, market research, tax advisory, business advisory, audit and similar services. In the FBiH WHT is levied on all services provided in the FBiH, while the RS levies WHT on all services delivered to RS entities, irrespective of the place where the services were actually provided.

In the FBiH WHT is not paid on interest from deposits, interest from state and corporative bonds, interest on commodity loans for the purchase of goods and interest on loans to purchase equipment to perform business activities.

Similarly, in the RS WHT is not paid, inter alia, on interest from deposits, interest from debt between a permanent establishment or a branch office and its foreign headquarters (provided that the local entity did not decrease its CPT base for the amount of interest), income from authorship rights that a permanent establishment or a branch office pays to its foreign headquarters (provided that the local entity did not decrease its CPT base for the amount) profit after tax of the local entity returned to a country of the foreign entity (if the foreign entity holds 10% or more shares in the local entity).

Please note that in practice the procedure for the registration of a permanent establishment of a foreign legal entity before the relevant authorities has not been developed. Foreign entities generally tend to register a legal presence in BiH prior to commitment of business activities in the country, prevalently in the form of a limited liability company.

The withholding tax rate may be reduced or eliminated if a Double Tax Treaty (DTT) is concluded between the consideration recipient's country of tax residence and BiH. A list of effective DTTs can be found in Appendix A.

Generally, in order to eliminate or reduce the WHT rate as prescribed by the applicable DTT, the resident payer of consideration must submit a residency certificate of the non-resident beneficiary, issued by the foreign Tax Authority and a statement that the non-resident beneficiary is the end-user of the income, written by that non-resident beneficiary.

6.2.2 Personal Income Tax

Overview and Introduction

Personal income tax (PIT) is regulated at the Entities' level.

As of 1 January 2009, a new PIT Law was implemented in the FBiH, abolishing previously applicable cantonal laws.

Generally, both entities (the FBiH and the RS) exercise the source rule to their residents and non-residents (Entities exercise the right to tax all individuals, whether resident in that entity or not, on income arising in that Entity), while residents are also taxed under the residence rule (residents are taxed on income that arises outside that specific Entity).

Tax Returns and Compliance

When are tax returns due?

- The FBiH – 30 April.
- The RS – 31 March

What is the tax year-end?

- 31 December in both jurisdictions (the FBiH and the RS)

What are the compliance requirements for tax returns in Bosnia and Herzegovina?

- The FBiH

The annual personal income tax return is due by the end of March following the year for which the tax is being assessed. Any tax liability assessed in the annual tax return must be settled by this date as well.

A taxpayer is not obliged to submit an annual personal income tax return if he/she has realised income from only one source (such as, employment), but a taxpayer can submit an annual tax return if he/she is entitled to a tax refund.

Individuals receiving income directly from abroad are obliged to calculate income tax on a monthly basis and to pay it within five days from the receipt of income.

- The RS

The annual personal income tax return is due by the end of March following the year for which the tax is being assessed. Income tax assessed must be paid by the end of March following the year for which the tax is being assessed.

A taxpayer is not obliged to submit an annual personal income tax return if he/she has realised income from only one source (such as, employment), but a taxpayer can submit an annual tax return if he/she is entitled to a tax refund.

Individuals receiving income directly from abroad are obliged to calculate income tax on a monthly basis and to pay it within seven days from the receipt of income.

Residents

The FBiH and the RS

All resident taxpayers who source any type of income from abroad may be required to submit an annual personal income tax return, if such income is subject to PIT in the FBiH/RS.

Non-Residents

The FBiH and the RS

Only the FBiH/RS sourced income of non-residents is subject to PIT in the FBiH/RS.

Tax Rates

What are the current income tax rates for residents and non-residents in Bosnia and Herzegovina?

- The FBiH

As of 1 January 2009, the tax rate applicable on personal income is 10 percent, and it applies to both residents and non-residents.

- The RS

As of 1 January 2009, the tax rate applicable on personal income is 8 percent, and it applies to both residents and non-residents.

Residence Rules

For the purposes of taxation, how is an individual defined as a resident of BiH?

- The FBiH

The FBiH PIT Law defines a resident taxpayer as an individual who:

- has permanent residence in the FBiH;
- spends a cumulative period of at least 183 days in the FBiH during any tax period; or
- has permanent residence in the FBiH and earns income by carrying out a dependent activity outside the FBiH that is paid from the budget of the FBiH and/or BiH.

A non-resident is considered to be an individual spending less than 183 days in the FBiH.

- The RS

A RS resident taxpayer is an individual who:

- has RS residency; or
- stays in the RS for a period of at least 183 days, continually or with interruptions, in a period that begins or ends in the relevant year.

A non-resident taxpayer is an individual who has residence in other country or Entity and realizes income in the RS.

Types of Taxable Compensation

What categories are subject to income tax in general situations?

Generally, all types of remuneration and benefits-in-kind received by an employee for services rendered may, under conditions prescribed by the law, constitute taxable income.

Tax-Exempt Income

Are there any areas of income that are exempt from taxation in Bosnia and Herzegovina?

- The FBiH

As per the FBiH PIT Law, the following payments/reimbursements are not considered to be taxable income in the FBiH:

- Compensation for losses incurred due to natural disasters and reimbursements based on injuries and illness paid by the employer to the employee or the employee's family members, not exceeding the amounts prescribed by special legislation.
- Meals provided by the employer at the employer's premises, in the value not exceeding the amounts prescribed by special legislation.
- Accommodation provided by the employer to the employee, provided that such accommodation is required in the course of performing the employee's duties.
- Accommodation and reimbursement of accommodation costs provided to public officials employed in diplomatic and consular offices abroad and other reimbursements paid, not exceeding the amounts prescribed by special legislation.
- Gifts provided by the employer to the employee for holidays, not exceeding the amounts prescribed by special legislation.
- Severance payments in case of termination of employment, not exceeding the amounts prescribed by special legislation.

The RS

The following payments/reimbursements are not considered to be taxable income in the RS:

- Severance payments due to retirement.

- Compensation for losses incurred due to natural disasters and reimbursements based on injuries and illness paid by the employer to the employee or the employee's family members, not exceeding the amounts prescribed by special legislation.
- Accommodation provided by the employer to the employee, provided that such accommodation is required in the course of performing the employee's duties.
- Accommodation and reimbursement of accommodation costs provided to, amongst others, public officials and individuals employed in diplomatic and consular offices abroad, in accordance with special legislation.
- Allowance for public transportation, not exceeding the amounts prescribed by special legislation.
- Reimbursement of travel expenses and daily allowances for business trips within and out of the country, not exceeding the amounts prescribed by special legislation.
- Reimbursement of reallocation costs, not exceeding the amounts prescribed by special legislation.
- Allowances for the use of a private car for business purposes, not exceeding the amounts prescribed by special legislation.

Salary Earned from Working Abroad

Is salary earned from working abroad taxed in BiH?

Yes, in case of BiH tax residents, that is, tax residents of the relevant entities. Residents must report their worldwide income. If the individual is working in BiH (that is, the relevant Entity) and in addition during the same calendar year earns a salary and pays foreign taxes for work performed abroad, such income and taxes paid must be reported in the annual personal income tax return, supported with a salary confirmation and formal evidence of the foreign taxes paid.

Personal Use Items

Any item taken for personal use of the assignee should be treated as a benefit-in-kind and as such taxable.

General Deductions from Income

What are the general deductions from income allowed in BiH?

FBiH

In calculating taxable income, every resident taxpayer is entitled to deduct the following from their monthly gross salary.

- A basic monthly personal allowance of BAM 300 for each month for which tax is being assessed (available only if employer calculates, withholds and pays personal income tax).
- Additional allowances if family members are qualifying.

- Employee compulsory social security contributions.

Additional annual deductions are available for taxpayers for:

- premiums for voluntary or additional life, health, or pension insurance (maximum deduction available is BAM 2,520 per year);
- health services and medicines bought in a year, under certain conditions; and
- interest paid on the basis of qualifying loans for the purchase or construction of the taxpayer's main residence.

Foreign earned income, which is taxed abroad, is also taxable in the FBiH, but a tax credit for taxes paid abroad may be applied to reduce tax otherwise paid in the FBiH. Double taxation treaties are also applicable.

RS

In calculating taxable income, every resident taxpayer is entitled to deduct the following from their monthly gross salary.

- A basic monthly personal allowance of BAM 250 for each month for which tax is being assessed (available only if employer calculates, withholds, and pays personal income tax).
- Additional allowances if family members are qualifying.
- Employee compulsory social security contributions.

Additional annual deductions are available for taxpayers for:

- premiums for voluntary pension insurance (maximum deduction available is BAM 1,200 per year); and
- interest paid on the basis of qualifying loans for the purchase or construction of the taxpayer's main residence.

Foreign earned income, which is taxed abroad, is also taxable in the FBiH, but a tax credit for taxes paid abroad may be applied to reduce tax otherwise paid in the FBiH. Double taxation treaties are also applicable.

Relief for Foreign Taxes

Is there any Relief for Foreign Taxes in BiH?

To avoid double taxation, under the domestic laws of BiH and its Entities and in accordance with tax treaties which BiH has concluded with a number of countries, the credit method generally applies to foreign earned income. Note that the credit for tax paid abroad may not exceed the amount of taxes due in BiH (that is, its Entities) on that foreign income.

6.2.3 Social Security Contributions

Are there social security contributions in BiH?

Employers in the FBiH or the RS need to withhold compulsory social security contributions.

Current social security rates on net salary in the FBiH (applicable for the year 2008 onwards) are as follows:

Type of Insurance	Paid by		Total Percent
	Employer Percent	Employee Percent	
Pension	6.00	17.00	23.00
Health	4.00	12.50	16.50
Unemployment	0.50	1.50	2.00
Special Water Tax	0.50	0.00	0.50
Special tax on protection from natural and other accidents	0.50	0.00	0.50
Total Percent	10.50**	31.00*	41.50

*Withheld from salary

**Paid in addition to salary

Current social security rates on net salary in the RS are as follows:

Category	Employee's part* (percent)
Pension	17.0
Health	11.5
Unemployment	0.7
Child protection	1.4
Total	30.6

*Withheld from salary

BiH has signed totalisation agreements with a number of countries which override BiH legislation. If there is no contractual agreement between the foreign national and the BiH legal entity to which the individual has been assigned, a totalisation agreement may exempt the individual from paying social security obligations for a certain period (provided certain conditions are met).

A List of Effective DTTs

BiH currently has a treaty for the avoidance of double taxation of income and property ratified and in effect with the following countries:

Countries with which BiH has signed a DTT, where the DTT is currently being applied	Countries with which BiH has signed a DTT, where the DTT is expected to come into force in 2011	Countries with which the former Yugoslavia signed a DTT, where the DTT is applied in BiH on the basis of succession	
<ul style="list-style-type: none"> • Croatia • Czech Republic • Iran • Moldova • Montenegro* • Pakistan • Serbia* • Slovenia • Turkey • UAE 	<ul style="list-style-type: none"> • Albania • Algeria • Jordan • Kuwait • Malaysia • Spain 	<ul style="list-style-type: none"> • Belgium • China • Cyprus • Denmark • Egypt • Finland • France • Germany • Hungary • Italy • Malaysia 	<ul style="list-style-type: none"> • Netherlands • Norway • Poland • Romania • Slovakia** • Sri Lanka • Sweden • United Kingdom and Northern Ireland

* Applies to each of the now separate states of Serbia and Montenegro based on the DTT signed with the former State Union Serbia and Montenegro

** Applicable based on the DTT with the former Czechoslovakia

A DTT with Ireland is in the process of ratification.

DTTs with the following countries are under negotiation or waiting to be signed: Austria, Belarus, Brunei, Bulgaria, Estonia, Italy (new DTT), Qatar, Libya, Lithuania, Hungary (new DTT), Macedonia, Malta, Russia, Saudi Arabia, Singapore and Syria.

B Social Security Treaty Network

Bosnia and Herzegovina currently has social security agreements in effect and ratified with the following countries:	
Austria	Netherlands
Belgium	Norway
Bulgaria	Poland
Croatia	Romania
Czech Republic	Serbia
Denmark	Slovakia
France	Slovenia
Germany	Sweden
Hungary	Switzerland
Italy	Turkey
Luxemburg	United Kingdom and Northern Ireland
Macedonia	
Montenegro	

C About KPMG and KPMG in Bosnia and Herzegovina

KPMG operates as an international network of member firms offering audit, tax and advisory services. We work closely with our clients, helping them to mitigate risks and grasp opportunities.

Our firms' clients include business corporations, governments and public sector agencies, not-for-profit organisations and individuals. They look to KPMG for a consistent standard of service based on a high level of professional capability, industry insight and local knowledge. KPMG member firms can be found in over 140 countries. Collectively they employ more than 135,000 people across a range of disciplines. Sustaining and enhancing the quality of this professional workforce is KPMG's primary objective. Wherever we operate we want our firms to be no less than the professional employers of choice.

Our people embrace KPMG's values. These values determine how we interact with clients, with each other and with the world around us. They define what we stand for and how we do things. We contribute to the effective functioning of international capital markets. We support reforms that strengthen the markets' credibility and their social responsibility. We believe that similar reform must extend to the professional realm.

At KPMG we try to create sustainable, long-term economic growth, not just for our member firms and their clients but for the broader society, too. We seek to be a good corporate citizen, making a real difference to the communities in which we operate.

KPMG in Bosnia and Herzegovina

KPMG's office in Sarajevo was established in 2000 and now employs 30 people who reports to 6 partners based in Zagreb who are responsible for our office in both Bosnia and Herzegovina and Croatia, who are members of KPMG's Central and East European (CEE) partnership, covering 19 countries in CEE. KPMG has now also opened a second office in Bosnia and Herzegovina, in Banja Luka, serving our clients in Republika Srpska.

Structure and Services

KPMG provides services across the globe under three main functions: Audit, Tax and Advisory.

<p>Audit</p>	<ul style="list-style-type: none"> • Reporting under Bosnian accounting requirements • Reporting under International Financial Reporting Standards (IFRS) • US GAAP and other reporting requirements 	
<p>Tax</p>	<ul style="list-style-type: none"> • Local and international taxation advisory services • Tax management strategies • Transfer pricing • Market entry assistance • Tax and regulatory reviews and due diligence • Tax and regulatory support in mergers and acquisitions • Assistance with negotiations and contract preparation • Foreign currency advisory services 	<ul style="list-style-type: none"> • Indirect taxation including VAT, customs and excise • Investment incentives • Labour Law and taxation of personal income including inter alia implications for foreigners • Incorporation, reorganisation and liquidation of legal entities • Real estate and construction issues • Tax accounting • Tax compliance

Advisory	<p>Financial Advisory Services</p> <p>Transaction Services</p> <ul style="list-style-type: none"> • Buy-side Assistance (Pre- and Post-Deal) • Sell-side Assistance (Pre- and Post-Deal) • Capital Markets Service IPO, Debt and Equity Assistance <p>Corporate Finance</p> <ul style="list-style-type: none"> • M&A Services • Valuations • Infrastructure and Projects • Debt financing and Real Estate Advisory <p>Restructuring</p> <ul style="list-style-type: none"> • Operational Restructuring • Financial Restructuring • Cash Management • Crisis Management • Insolvency • Turnaround Executive Management <p>Forensic</p> <ul style="list-style-type: none"> • Investigations • Fraud Risk Management • Dispute Advisory Services • Regulatory Compliance • Forensic Technology <p>Risk & Compliance</p> <p>Internal Audit Services</p> <ul style="list-style-type: none"> • Internal Audit • Enterprise Risk Management • Corporate Governance • Regulatory Compliance • Sustainability Services 	<p>Financial Risk Management</p> <ul style="list-style-type: none"> • Credit Risk • Market Risk • Operational Risk • Insurance Risk • Actuarial Services • Financial Statement Support • Capital Adequacy & Regulatory Services • Financial Instrument Accounting <p>Accounting Advisory Services</p> <ul style="list-style-type: none"> • Global Conversion Services • Quality Close • Accounting Support • IPO Reporting Advisory • Post Deal Accounting Advisory • Government Reporting Implementation Process • Bookkeeping services • Payroll services <p>Performance & Technology</p> <p>Business Performance Services</p> <ul style="list-style-type: none"> • Business Process Sourcing • Business Process Improvement • Change Management • Financial Management <p>IT Advisory</p> <ul style="list-style-type: none"> • ERP Controls Integration • Security Services/ Security, Privacy and Continuity • IT Attestation • IT Project Advisory • IRM in External Audit • IRM in Internal Audit / IT Audit • IT Strategy & Governance • IT Sourcing

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