TAX AND FINANCE COMMITTEE

OBJECTIVE 1: REDUCE ADMINISTRATIVE BURDEN ON FOREIGN EXCHANGE OPERATIONS

…BY AMENDING THE FOREIGN EXCHANGE OPERATIONS LAW

CHALLENGE: As it stands, the Foreign Exchange Operations Law poses a major burden on using emerging technologies, creates large administrative costs, and slows transactions down, and in doing so jeopardises performance and makes it more difficult for start-ups and small businesses to access finance. This has had an adverse effect on the expansion of Serbian companies throughout the region, making them less competitive, and has particularly adversely impacted the development of the digital economy, a key requirement for achieving sustained high growth in the future.

The current law was enacted in 2006 and amended on multiple occasions, but none of these changes has addressed businesses' key concerns, such as opaque restrictions and excessive administrative requirements. Its effects have recently become much less predictable as the regulator has tended to interpret it in a widely varying fashion. The principal challenges here involve:

a) Interpretation based on an 'exhaustive permissions' approach (meaning that anything not explicitly allowed is deemed to be prohibited) hinders implementation whilst requiring amendments to legislation to introduce new technologies;

b) Not all restrictions are regulated by law, and many are governed by the extensive body of secondary legislation;

c) The NBS requires ex ante inspection of documents for each foreign exchange transaction (credit operations and guarantees), which leads to varying interpretations that are often not properly explained or publicly available;

d) The administrative burden caused by the document inspection requirements for foreign exchange transactions makes these operations unduly slow and expensive as they prohibit straight-through processing by banks.

RECOMMENDATION: Overhaul the statutory framework to **replace ex ante inspection of documents for each individual transaction with a risk assessment and management system** dependent on transaction type, size, and the like. Improvements to the regulations ought to include:

- Changing the legislative drafting method employed to **set out all prohibitions in the actual law** whilst using secondary legislation to clarify how the rules should be implemented but not to introduce additional restrictions;
- **Abolishing ex ante document inspection, and in particular the registration requirement** (which is tantamount to advance approval) **of each foreign credit operation** (and replace it with either actual registration or ex post reporting) and **liberalise guarantee operations** (e.g. on the model of the Croatian reform of 2003);
- **Facilitating foreign payment operations by removing the requirement for banks to inspect the relevant documents in advance,** and moving to **use of payment codes exclusively for statistical purposes** instead of these being mandatory for transaction approval; and
- **Streamlining and facilitating the assignment and set-off of foreign receivables and payables** (on the model of the Croatian reform of 2003).

These efforts would in no way affect the power of the Serbian Government and the National Bank of Serbia (NBS) **to introduce temporary restrictions on some foreign currency and cross-border transactions assessed as posing risks in the event of major threats to the country's macroeconomic and fiscal stability.**

…BY STREAMLINING INSTEAD OF COMPLICATING CROSS-BORDER TRANSACTION REPORTING, IN ACCORDANCE WITH EU PRACTICE

CHALLENGE: Current foreign exchange regulations impose administrative reporting requirements on some cross-border transactions, with the data collected being used for balance of payment statistics. Without wishing to deprecate the importance of these statistics, we feel the method of their collection imposes an undue burden on cross-border transactions, slowing them down and making them more difficult and costly. Even though all EU Member States collect such data, none currently uses the Serbian approach (the last EU Member State to have utilised this procedure revoked it in 2011). These already complex regulations were made even more challenging by amendments to the Decision on Terms and Conditions of Performing Foreign Payment Transactions, which were enacted in mid-July 2020 and will take effect on 1 January 2021. Paragraph 50 of the new Decision introduces new data collection rules that will require banks to alter all payment or collection order forms in both their back-office software and consumer-facing online services, which will in turn create new costs for the banking sector and businesses. For their part, companies will face increased costs of administration, as they will have to provide vast quantities of information, initially manually, and will then incur additional expense in having to adjust their software. Firms that use SWIFT for wire transfers will encounter difficulties as the limited number of characters will restrict them to including no more than three or four invoices in one transfer orders, which will result in the need for more transfer orders and so increase costs for clients. The transition period of slightly less than months would be insufficient even under normal circumstances and is especially so given the Covid-19 pandemic, with major IT resources already invested in applying other regulatory measures.

> **RECOMMENDATION:** Repeal Paragraph 50 of the Implementing Instructions for the Decision on Terms and Conditions of Performing Foreign Payment Transactions and continue to streamline rather than complicate transactions by imposing new data collection requirements. Review models used to collect balance of payments statistics in EU Member States and reform the NBS's data collection arrangements accordingly.

OBJECTIVE 2: INCREASE TRANSPARENCY OF CHANGES TO TAX RULES AND FACILITATE COMPLIANCE

…BY MANDATING CONSULTATIONS BEFORE REGULATIONS ARE ADOPTED AND ENACTING CLEAR TAX RULES

CHALLENGE: On the whole, the Serbian tax system is well designed, and most of the country's tax rates are competitive. In recent years, there have been initiatives for a very gradual reduction in payroll taxes, an approach in principle welcomed by the business community, but no major effects have yet materialised.

In the past several years, the chief concern of the business community have been annual amendments to tax rules **with limited or no prior consultation with the business and professional community,** which has made the tax environment less predictable and at times led to inconsistency between tax regulations; a particularly pressing issue is the implementation of new regulations. Additionally, the **secondary legislation** that ought to facilitate the implementation of laws and provide detailed instructions (on, for instance, the Value Added Tax Law) is **restricted** to addressing only isolated matters that the law explicitly singles out for elaboration in these statutory instruments. Formal opinions of the Ministry of Finance (MoF) are the only source of information for taxpayers as to how the tax authorities will interpret tax laws and regulations. The procedure for issuing these opinions are lengthy and they often fail to provide clear answers to taxpayers' question. The problem is compounded by the fact that the Tax Administration often ignores these opinions when performing tax audits.

> **RECOMMENDATION:** Ensure that all amendments to tax laws are **subjected to public consultation in due time** before entering parliamentary procedure for enactment.

…BY DEVELOPING COMPREHENSIVE REGULATIONS ON THE APPLICATION OF KEY TAX LAWS

> **RECOMMENDATION:** The MoF ought to issue **binding and detailed rules that govern how tax laws are applied** for all types of taxation, including corporate income tax (CIT), value-added tax (VAT), and property tax. These rules should provide detailed explanations for how each individual provision of any tax law is to be applied and interpreted. Unlike the MoF's current opinions, **these rules would be binding not only on taxpayers and the Tax Administration, but also on the courts.** Lastly, in contrast to the opinions, the rules would prescribe general requirements applicable to various situations. (In legal terms, an opinion is binding only on the specific set of facts in relation to which it is issued.)

OBJECTIVE 3: ENHANCE DECISION-MAKING IN TAX DISPUTES

…THROUGH CONTINUED SPECIALISATION AND TRAINING

CHALLENGE: Decision-making in disputes is the weakest link in Serbia's tax system. Some progress has been made by shifting responsibility for decision-making in second-instance tax disputes from the Tax Administration to the MoF, as had been recommended by AmCham's Tax and Finance Committee. Only the Administrative Court can perform judicial review of the Tax Administration's decisions, but it lacks the capacity to address complex tax-related cases. The Administrative Court has no judges or judicial panels specialising in tax matters, notwithstanding its importance and complexity, so cases are heard by judges who lack appropriate in-depth knowledge of the field.

> **RECOMMENDATION:** Ensure court units or individual judges at the Administrative Court are specialised in tax law and introduce continued and comprehensive training for Administrative Court judges (especially those who specialise in tax cases) at the Judicial Academy.

OBJECTIVE 4: COMPLETE REFORM OF PARA-FISCAL LEVIES

…BY REGULATING THE ENVIRONMENTAL IMPROVEMENT AND PROTECTION CHARGE

CHALLENGE: The Law on Charges for Use of Public Resources, adopted in 2018, regulated these non-tax levies. Nevertheless, in 2019 the environmental improvement and protection charge was overhauled twice in the space of months; the current version does not follow the 'polluter pays' principle and so does not disincentivise reductions in measured emissions.

> **RECOMMENDATION:** Merge this levy with the pollution charge (including broadening its scope to ensure the charge is paid by all entities required to measure emissions) and assess it using the pollution charge assessment formula (to ensure the charge is proportional to the pollution generated). Ensure the funds raised through the pollution charge are divided between the central and local budgets. Leave responsibility for assessment at the national level and make local inspections responsible for tracking compliance.

OBJECTIVE 5: PERMIT USE OF DIGITAL SERVICES IN FINANCE AND TAX

…BY DEVELOPING DIGITAL IDENTITY ARRANGEMENTS, EXCHANGE OF INFORMATION, AND OPEN BANKING

CHALLENGE: Any improvements to user experience, procedures, and automation of processes in financial services depend exclusively on enhancements to regulations and exchange of relevant information between the public and the private sector.

RECOMMENDATIONS: These recommendations are designed to promote the development of digital identity arrangements, exchange of information on natural and legal persons between banks and public authorities such as the Tax Administration and the Pension and Disability Insurance (PIO) Fund to facilitate creditworthiness assessments, and use of open banking solutions to improve user experience and automate processes.

- **Digital identity.** Initial progress with remote identification regulations was made recently as video technology and two-factor identification were introduced for contracts not exceeding RSD 600,000 entered into between natural and legal persons and financial institutions supervised by the NBS. One option for allowing remote contracting for firms from other industries would be to establish a national system for storing private individuals' digital identities, which would enable members of the public to sign any contract electronically (with the equivalent of a physical signature) by using a mobile app to access their electronic signature stored in the cloud. The only precondition for making this service generally available would be initial remote identification of clients, which could be done using video, provided that the law is amended accordingly. Digital identity is used in Nordic countries (Sweden, Norway, Finland, and Denmark), where banks have led the development of national 'BankID' schemes that have permitted citizens to receive electronic signatures after providing identification at any of the participating banks. A similar example exists in the UK, where users upload mobile phone self-portraits ('selfies') via an app and back-end automation compares the selfie with the person's ID picture to make a positive identification, with the added security of 'liveness detection' (which ensures the picture is that of the actual real person).
- **Exchange of information on natural (and legal) persons with the Tax Administration and PIO Fund.** This issue is of crucial importance for continued digitalisation of retail transactions, but also has a bearing on corporate banking. Data could be shared either with the tax authority or the PIO Fund; this automatic exchange of information would require client consent and would permit banks to either directly or indirectly determine their clients' incomes. Similar examples of information sharing between public authorities and the private sector can be found in both neighbouring countries and EU Member States more generally (such as Slovakia, Croatia, Romania, and Bulgaria).
- **Open banking (Payment Services Directive 2).** Allowing open banking (by incorporating the EU's Payment Services Directive 2, or PSD2, into Serbian law) would make it possible for emerging non-financial institutions (also known as fintech companies) to offer some services currently provided only by banks, thereby increasing competition. This concept would also permit straightforward exchange of information between banks on clients and their use of banking products, leading to faster procedures and better user experience (such as additional automation of loan approvals, use of simplified account switching to open bank accounts, and the like).

…BY CLARIFYING TAX ASPECTS OF E-INVOICING

CHALLENGE: The Accounting Law regulates e-invoicing, but the tax aspects of these invoices must be clarified, especially in relation to VAT and the powers of the Tax Administration in this regard.

RECOMMENDATION: The VAT Law already permits invoicing requirements to be regulated by secondary legislation. Therefore, we believe the VAT Regulation should be used clarify all issues related to e-invoicing and tax audits in this regard.

OBJECTIVE 6: ENHANCE TAX REGULATIONS

…Personal Income Tax

CHALLENGE: An MoF opinion dating from February 2019 and the subsequent amendment of Article 18 of the Personal Income Tax Law have imposed **major administrative burdens on businesses by requiring them to**

collect documents to substantiate employee costs incurred in travelling to and from the workplace. As the monthly ceiling of RSD 3,998 has remained unchanged and the public revenues collected are minimal, the supplementary requirements have only increased administrative costs of doing business. Moreover, only costs of public transport, personal car use, and taxis are admissible, which unjustly discriminates against employees who use more environmentally sustainable modes of travel, such as cycling or walking to work. We feel these tax disincentives for environmentally friendly modes of transport are unacceptable, especially given the air pollution issues present in Serbian cities and towns.

> **RECOMMENDATION:** Delete the word 'documented' from Article 18(1)1 of the Personal Income Tax Law and repeal the February 2019 MoF Opinion.

CHALLENGE: Taxation of a foreign national's remuneration for work done in Serbia when invoiced as a service.

Article 100a of the Personal Income Tax Law governs the assessment and payment of income tax in the event that income is received from a foreign legal person. This article stipulates that a taxpayer paid a salary from, or earning other income in, another country is required to self-assess and pay withholding tax as envisaged by the Law unless the payer has done so.

Pursuant to Articles 99 and 101 of the Law, a Serbian legal person that pays income to a natural person is required to assess, withhold, and pay withholding income tax.

In practice, however, the authorities have not been consistent in interpreting the Law. When auditing Serbian businesses operating as part of multinational groups that employ temporary staff seconded from abroad who remain employed and continue to be paid by their foreign parent companies (in some cases having employment contracts with both the Serbian and the foreign business), the Tax Authority has frequently cited Articles 99 and 101 of the Law to support its rulings that the Serbian firms were required to assess and pay tax on income paid from abroad as if they had paid such income, since the Serbian businesses had incurred costs in relation to salaries of these staff paid from abroad (because the foreign parent companies had invoiced these salaries as service costs).

This approach leads to double taxation:

1. Firstly, when the natural person self-assesses and pays payroll tax, and, subsequently, annual personal income tax;
2. Secondly, as questionably assessed by the Tax Authority in its audits, resulting in the already taxed income again being considered taxable for purposes of assessing annual personal income tax.

Apart from causing the double taxation issue, this practice has led to criminal charges being brought against responsible officers of Serbian companies even though the relevant tax had previously been paid on time and in accordance with the Law.

> **RECOMMENDATION:** This issue has persisted for over a decade and apparently cannot be resolved through the usual expedient of seeking an official opinion from the MoF. A joint effort should be made to address the problem by clarifying Articles 99, 100a, and 101 of the Personal Income Tax Law and so eliminating this cause of legal insecurity. A solution should be sought through an official internal instruction for the Tax Administration and a binding piece of secondary legislation that would follow the views of the MoF as expressed in its official opinions. These rules should re-affirm the position that Article 100a requires natural persons to declare income received from abroad, regardless of whether the Serbian business had incurred any costs in relation to salaries paid from abroad to staff seconded by their foreign parent companies.

For years, one of the current tax topics has been…

…Value-Added Tax

CHALLENGE: Application of Article 10(2)3) of the VAT Law to goods and services in the construction industry.

Companies' tax and finance specialists and external accountants waste much time on attempts to interpret areas in which they have next to no knowledge, including determining whether an activity indicated in an invoice belongs to the construction industry. Quite apart from their complex nature, existing rules also promote insecurity for taxpayers, chiefly because they reference non-tax regulations (such as industry classifications) that are inherently unable to offer an unambiguous answer as to whether a particular transaction belongs to the construction sector.

> **RECOMMENDATION:** Repeal the Regulation on the Determination of Goods and Services in the Construction Industry for Purposes of Identification of Value-Added Taxpayers (*Official Gazette of the Republic of Serbia*, No. 86/2015) and prescribe clear rules for applying the law.

CHALLENGE: Disproportionate administrative obligations regarding the registration, as a VAT payer, of a foreign person who exclusively dispatches abroad goods in the process of customs warehousing.

The amendment to Article 10a of the Law on Value Added Tax, which has been in force since January 2020, introduced the obligation of VAT registration for foreign persons who trade in goods and services in situations when a tax exemption is prescribed, with the right to deduct previous tax - therefore when VAT is not paid in the Republic of Serbia.

The prescribed obligation to register includes the situation when a foreign person enters goods into the customs territory of the Republic of Serbia, where it remains monitored by the RS customs authority, by issuing documentation in the customs supervision procedure until re-export from the RS customs territory. These goods are not put into free circulation, i.e. they are not imported into the territory of Serbia.

In this particular case, it is a business model that implies that large foreign companies open regional logistics centers in Serbia that serve to keep stocks in order to meet the needs of local markets in this part of Europe at any time. Optimized supply chain, i.e. keeping goods at a location near these markets (Southeast European countries) is an important part of the business strategy of these companies, and Serbia is considered a convenient location precisely because of its central position in the region. According to this model, the flow of goods would imply that from one foreign country (e.g. factory or warehouse in Poland), the goods are transferred to another foreign country (e.g. North Macedonia) only with a temporary physical stoppage in the customs warehouse in Serbia.

Bearing in mind that due to the application of the export tax exemption (pursuant to Article 24 of the Law), VAT is certainly not paid in RS, the obligation of a foreign taxpayer would be to actually submit blank VAT returns, i.e. applications without VAT, we point out that in this way the administrative burden is inappropriately imposed on non-resident persons who operate in Serbia in the manner described above.

This provision of the Law does not stimulate companies to choose Serbia as a regional logistics center in the region, which means that the state / fiscus, in this respect may lose potential revenues that would arise as a result of providing warehouse lease services and related logistics services (goods handling services, transportation, mediation etc.) in Serbia.

> **PROPOSED SOLUTION:** Amendment of Article 10a of the Law on Value Added Tax so that non-residents who exclusively ship foreign goods that are within the customs procedure abroad, i.e. do not release goods for free circulation in RS, are exempt from mandatory VAT registration.

…Corporate Income Tax

CHALLENGE: Write-off of individual outstanding loan claims. The latest amendments to the Corporate Income Tax Law have introduced a provision whereby a firm may write off an individual claim under an outstanding loan extended to an unrelated person as an expense in its tax balance, provided that the claim became due at least two years previously and that documents are duly provided that substantiate the borrower's inability to pay. The law does not clearly indicate whether the due date is the date on which the entire loan was accelerated, or whether this is the date on which the borrower defaulted on its 'oldest outstanding instalment' (regardless of whether the default relates to the principal, interest, a fee, or any other claim). Moreover, the law does not stipulate which documents the tax authorities would find acceptable in an audit to substantiate the borrower's inability to pay.

> **RECOMMENDATION:** To avoid variations in interpreting this provision, the MoF should issue a specific formal opinion to clarify what should be considered the due date: the date on which the entire loan was accelerated, or the due date of the oldest instalment/individual claim the borrower has defaulted on. Additionally, this opinion should explain which documents, as set out in the lender's internal rules, will be considered sufficient proof of the borrower's inability to pay for purposes of tax audit.

> **RECOMMENDATION:** Repeal the 2015 MoF Opinion related to this issue.

CHALLENGE: Recognising the difference between a decommissioned asset's tax value not written off and book value not written off as depreciation expense.

Taxpayers whose investments into fixed assets exceed 10 percent of these assets' book value must apply new depreciation rules to the entire value of such assets. In these cases, especially for some asset categories (such as intangible investments) where book depreciation far exceeds tax depreciation, the switch to the new rules results in the loss of much of the depreciation base, meaning that taxpayers are liable to face lasting differences in tax. The new Regulation on Depreciation of Fixed Assets Recognised for Tax Purposes has introduced a rule that to some extent mitigates these adverse effects by recognising the difference between tax value not written off and book value not written off as depreciation expense, however this only applies to cases where the fixed asset has been alienated or destroyed. The scope of the Regulation should be extended to also cover situations where the fixed asset has been decommissioned, as there will be fixed assets that a taxpayer will not destroy or alienate but will nonetheless cease using (such as various accounting and client databases and other records).

> **RECOMMENDATION:** Amend the Regulation on Depreciation of Fixed Assets Recognised for Tax Purposes to allow recognition of the difference between a decommissioned asset's tax value not written off and book value not written off as depreciation expense.

CHALLENGE: Regulations governing permanent establishments - Tax rules for permanent establishments are at present rudimentary and make it difficult for foreign companies temporarily operating in Serbia to declare and pay income tax. The only option for paying income tax is to have the foreign business incorporate a branch office or company in Serbia, which imposes a major administrative burden for firms intending to operate in the country for limited time only (e.g. for short projects and the like). Many developed countries permit 'tax registration' of foreign firms, allowing them to declare, assess, and pay tax without having to formally set up a permanent establishment by incorporating a branch office or company. A similar arrangement already exists for VAT, where registration is possible using VAT proxies.

> **RECOMMENDATION:** Expand and clarify tax rules for permanent establishments, perhaps by enacting a special regulation that would govern all relevant aspects of taxation in detail. The Tax Administration should develop a user-friendly and efficient system for registration of non-resident companies with permanent establishments in Serbia.

…property tax

CHALLENGE: Allowing small and medium-sized businesses to assess property tax at fair value.

The Property Tax Law allows taxpayers to assess tax at fair value if they use IAS/IFRS fair value valuation in their books of account. The MoF's opinions state that this provision should be taken to mean that only businesses that fully apply IFRSs and carry real estate on their books at fair value may use it to assess property tax, which raises issues for companies that apply more simplified IFRS requirements for small and medium-sized enterprises (SMEs).

> **RECOMMENDATION:** Essentially, there ought to be no difference in fair value valuation between taxpayers that use IFRSs and those that use IFRSs for SMEs (as corroborated in the recent MoF Opinion 011-00-156/2019-16 of 19 March 2019). We therefore believe it would be beneficial to clarify (ideally, through amendments to regulations) that this tax assessment option is also available to taxpayers that use IFRSs for SMEs.