IMPROVING BUSINESS ENVIRONMENT IN THE AREA OF FINANCE AND TAX REGULATIONS

AmCham Tax and Finance Committee

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Executive summary

Serbian tax system as a whole is conceptually well designed and tax rates are generally competitive. In the last quarter of 2015 all tax laws have been amended, without prior public discussion. Tax Administration has been mandated with a thorough reconstruction, which is ongoing for the last two years, mostly due to the need to tackle grey economy and stabilize the budget. Regarding the general application of the tax rules, certain positive steps have been made in the recent period, primarily related to the electronic filing, which resulted in improvement in Serbia's Doing Business ranking through improvements in the indicator regarding paying taxes.

During 2015-2016 members of American Chamber of Commerce in Serbia (AmCham Serbia) have reported overall decrease of predictability of changes in the tax rules and the consistency in their application. Frequent changes to the tax regulations, without public discussions with business and professional community, led to increased unpredictability of the tax environment as well as the problems of implementation of the new rules. While the introduction of binding force of the opinions of the Serbian Ministry of Finance in 2013 was an improvement in the overall legal security in the area of tax, there are instances when these opinions are not observed by the tax inspectors in tax audits. This is in part due to the fact that the Tax Administration does not have the sufficient and adequate human capital to deal with increasingly complex tax environment. The ongoing reform of the Tax Administration has started almost 2 years ago and is still ongoing. Despite the announcements that it will effect higher predictability and uniform application of tax rules, these results are still expected.

About AmCham Serbia Tax and Finance Committee

American Chamber of Commerce in Serbia (AmCham Serbia) is a leading business association composed of 190+ companies united by a will to improve business environment, support the economic reforms and implement best business practices.

AmCham Tax and Finance Committee strives to contribute to the improvement of finance and tax related legislation and its consistent implementation, in order to establish a transparent and effective regulatory framework in accordance with international standards and modern business practice.

The Committee fosters constructive dialogue and partnership between business community and the relevant state authorities with the aim to develop better predictability and transparency in the tax system, as one of the key priorities for improving the business environment, identified by AmCham Serbia member companies by the end of 2014.

With this in mind, Tax and Finance Committee's focus in the previous period was to improve the predictability of the tax/non-tax burden on businesses through long-term planning for tax law amendments and by reducing the likelihood of the introduction of, or increases in, parafiscal charges, at either central or local level.

At the same time, AmCham members view appellate procedure to the first instance rulings by tax inspectors as inadequate and powerless to effectively rectify deficiencies in the first instance rulings. Second instance procedure is entrusted to the same institution that issues first instance rulings – separate division of the Tax Administration. Even in cases when second instance tries to rectify decisions of the first instance, inspectors are not sufficiently compelled to implement second instance rulings. The final instance in the tax dispute is the Administrative Court, which is inefficient for protecting rights of the taxpayers as adjudication of tax cases is very slow, while obligation to pay tax under disputed ruling takes effect immediately.

For these reasons, AmCham Tax and Finance Committee focuses its efforts on tackling above stated problems aimed at **securing transparency and predictability** of the tax system. It advises for mandatory public discussion of amendments to tax regulations, transparency of internal guidelines of the Tax Administration and advocates for enactment of detailed by-laws for implementation of all tax regulations (instead of specific case based opinions). It also advises for **improving efficiency and fairness** of the appellate procedure through transfer of second instance resolution of tax disputes back to the Ministry of Finance, and improving capacity of the Administrative Court to deal with tax related cases.

The Committee's greatest accomplishments during past two years were:

• Improvement of the predictability of the tax and non–tax burden by amending the Decree regulating the compensation of business travel expenses for civil servants;

• Partial improvements to the regulatory framework for the liquidity of businesses by providing comments to the Law on Enforcement and Security and addressing the problem of NPLs;

• Improvement of the practice of the Tax Administration through electronic tax filing, while uniformity of practice and the predictability of the tax laws remained arguable.

In the upcoming period Tax and Finance Committee will devote its efforts to:

• Advocating for more transparent and predictable processes for changes of tax laws and accompanying tax regulations, as well as increasing transparency and availability of implementing regulations and Ministry of Finance and Tax Administration's internal acts.

• Establishing regular and structured channel of communication between AmCham Serbia and Tax Administration;

• Advocating for improving appellate procedures, and capacities of the institutions to the capabilities of police, prosecutors and courts to deal with tax related disputes;

• Addressing transparency, simplicity and predictability of the tax system, via removal and/or re-classification of parafiscal charges.

• Advocating for the changes in existing tax legislation in line with AmCham membership inputs.

AMCHAM SERBIA
A LEADER IN CHANGE

KEY ISSUE No.1: Transparency of Tax Regulatory Framework

Problem

One of the main problems in Serbia's tax system is a very un-transparent and, at instances, almost secretive process for adoption and amendment of both the systemic tax laws and accompanying tax regulations. In the past couple of years tax laws have been amended without any consultations with business and professional community, mostly in urgent procedures. The result is, first, the general unpredictability of the tax environment, but also a number of partial and technically inconsistent legislative solutions, which often create significant confusion in the business community with little or no impact on efficiency and volume of Government's tax revenues. Tax regulations (providing guidelines for application and interpretation of tax laws) are very basic, and often confusing (primarily in the area of VAT).

Serbia does not have regulations which would provide technical solutions for the application of general tax rules prescribed by the tax laws, such as the case in almost all other tax jurisdictions, both in the region and in the EU. The only way in which the taxpayers can get any kind of guidance as to how will tax laws and regulations be interpreted by the tax authorities are the opinions of the Ministry of Finance. While these opinions have been useful (especially after introduction of their binding force) this is not sufficient. The issuance of the opinion is a long process, which often ends in an opinion which does not provide a concrete answer to questions asked by the taxpayers. Moreover, these opinions are often ignored by the Tax Administration in the tax audits.

Action Points

- Ensuring that all proposals of changes in tax laws are communicated to the general public well in advance to their submission to the national Parliament. Businesses (both big and small), tax practitioners, professional associations as well as academic community have to be given the opportunity to give their comments and proposals to proposed changes in an open, organized and transparent process of public debate.

- The Ministry of Finance should issue binding and detailed regulations for the applications of tax laws, in all areas of tax: corporate income tax, VAT, personal income tax and property taxes. These regulations should provide detailed explanation as to how should each individual rule prescribed by the tax laws be applied and interpreted. Unlike the opinions of the Ministry of Finance, these regulations would be binding, not only on the taxpayers and on the Tax Administration, but also on the courts. Also, unlike the opinions, tax regulations would prescribe general rules applicable to different types of situations (legally, the opinions are binding only with respect to concrete set of facts in relation to which the opinion was issued). Finally, tax regulations would also ensure necessary flexibility and adaptability in the application and interpretation of tax laws, as they can be changed and supplemented by the Ministry of Finance, without having to go through lengthy legislative process before the Parliament.

- Tax Administration must publish and make available all its internal instructions and procedures (such as instructions for conduct of tax audits, etc. These acts have only internal character and are not binding on neither the taxpayers nor on the tax administration. Nevertheless, they are valuable source of information for the taxpayers and should therefore be made available to them.

KEY ISSUE No. 2: Improvement of System for Adjudicating of Tax Disputes

Problem

Dispute resolution system is the weakest point of the Serbian tax system. The Tax Administration decides in tax disputes both in the first and in the second instance. Judicial control of Tax Administration is limited only to one instance (Administrative Court) which does not have the capacity to handle complex tax cases. Unlike decision of courts in civil disputes, appeals against first-instance resolutions of the tax inspectors (who have much less resources to render a good decision then professional judges) do not suspend the execution of the first-instance resolution. As a result, the taxpayers must first pay tax and interest for late payment of tax and then wait for at least couple of years before the Administrative Court gives its final word as to whether they were indeed required to pay tax.

In the absence of effective tax judiciary, both the tax authorities and taxpayers are left without any judicial guidance in interpretation of tax laws, which, in developed tax jurisdictions is the main and most authoritative source of interpretation of tax laws.

Action Points

- Establish regular meetings with Tax Administration, Ministry of Finance and Administrative Court to discuss the efficiency of adjudication of tax-related disputes, and offer assistance in increasing the capacity of the Administrative Court to resolve these disputes.
- Establish regular channel of communication with the Office of Public Prosecutor and the Tax Police to discuss problems in prosecution of tax offences
- Submitting initiative for the transfer of second instance resolution of tax disputes back to the Ministry of Finance.
- Advising for introduction of the system in which an appeal suspends the execution of the first instance resolutions of the tax inspectors.

Specific Issues and Suggestions for Improvement

Corporate Income Tax

Withholding tax for services provided by foreign suppliers (non-residents) to resident economic operators

Fees for services rendered or used, or to be rendered or used, in the territory of the Republic of Serbia are subject to tax. The said services subject to withholding tax are broadly treated, which leads to a number of dilemmas in practice (e.g. question whether the service is used in Serbia or not) and creates room for different interpretations.

Tax-related paperwork incurs additional costs for taxpayers, primarily due to insufficiently precise regulations (clearly shown by numerous opinions of the Ministry of Finance given in the previous period) as well as to the necessity of obtaining tax residence certificates for service providers for the purposes of implementing provisions of the agreement on double taxation avoidance.

Action Points:

- A bylaw needs to be adopted urgently, precisely defining what is understood by the term services used or to be used in the territory of the Republic of Serbia.
- In addition, it is necessary to amend the current and broadly formulated definition of the subject matter of taxation in the Corporate Income Tax Law in order for this essentially anti-evasion measure to have full effect and at the same time to minimize administrative costs for law-abiding taxpayers.

Withholding tax for services – filing a tax return

Pursuant to Article 71, paragraph 1 of the Corporate Income Tax Law, the payer is to calculate, withhold and pay withholding tax on income referred to in Article 40, paragraph 1, point 5) of the Corporate Income Tax Law into appropriate accounts on the day when the income was realized i.e. paid in, for each taxpayer and for each individually realized i.e. paid income. Tax returns for withholding tax are filed on the day the payment of the income subject to withholding tax is made.

The main problem in this case arises due to the fact that taxpayers are not always able to get information on that same day that a fee was paid to a non-resident (bank statements or SWIFT messages arrive on the following day), and in addition it is then that a taxpayer as well has a valid document that the payment was made, and thus may calculate the tax at the exchange rate on the payment day. However, this is in contravention of the applicable legal provisions, and additionally, if tax returns were filed at a later time, then it would be necessary to calculate interest for delay in paying the tax.

Action Points:

- It should be defined that tax returns for this type of services are to be sent every ten days.

Withholding tax for services – filing a tax return

Filling out a tax return for withholding tax should be eliminated if the relevant tax liability is not present. The obligation to fill out a tax return and append to it the residence certification is still imposed, regardless of the fact that tax rate is 0%, namely there is no payment obligation.

Action Points:

- Cease reporting if tax liability is not present.

Writing-off the value of individual loan receivables

With the latest amendments to the Corporate Income Tax Law, the legislator introduced a new provision based on which expenditures in tax balance sheet may include the write-off of the value of individual receivables based on a loan granted to an unrelated party, provided minimum two years has passed since the receivable maturity date and the documents constituting the evidence for proving the debtor's inability to perform his monetary obligations are duly provided. The legislator did not specify whether the time the entire receivable is declared to have become due is to be deemed the maturity date, or if the maturity date is to be determined based on the default in settling 'the oldest 'defaulted installment (regardless of whether the default is on the payment of principal amount, interest, a fee, or other receivable). Further, it is not possible, based on legal provisions, to say which documents precisely would be accepted by the tax control as suitable evidence proving the inability of a debtor to fulfill his monetary obligations.

Action Points:

- To avoid possibility of differing interpretations of this legal provision, the Ministry of Finance should specify, in a separate opinion, what is precisely to be deemed the maturity date of a receivable: the time when the entire receivable is declared to have become due, or the due date of the oldest installment /individual receivable based on which the debtor is in default. Moreover, this opinion should specify that, in view of tax control, the documents defined by internal regulations of the bank concerned shall be deemed suitable evidence proving the debtor's inability to fulfill his monetary obligations.

Calculating tax depreciation for immovable properties

Considering that, for fixed assets, classified into non-current assets, or immovable property, the Corporate Income Tax Law provides that tax depreciation is calculated on the purchase price and the Rulebook provides that it is calculated on the value that was not written off, the Ministry of Finance has issued two, mutually contradictory, Opinions:

- MF Opinion No 430-07-55/2005-04 of 5 October 2005 defines that, for fixed assets acquired before 1 January 2004, depreciation is calculated on the value of fixed assets that was not written off as of 31 December 2003. According to the MF Opinion, considering that the base for depreciation for fixed assets classified into Group I is the purchase price of the fixed asset, the provisions of Article 9 of the Rulebook apply only to the fixed assets classified into Groups II-IV,

- MF Opinion No 413-00-97/2013-04 of 9 November 2015 specifies that the value of fixed assets, assets in Group I included, that was not written off is the base for calculating depreciation.

If business operators comply with the most recent Opinion of the Ministry of Finance, they would be under obligation to file amended tax returns. Moreover, the inconsistency of laws, bylaws, and the Opinions of the Ministry of Finance is a cause of confusion in taxpayers with regard to how to implement the tax depreciation related legislation for capital assets belonging to Group I.

Action Points:

- Ministry of Finance 2015 Opinion should be repealed.

Permanent business units

The rules on the taxation of permanent business units are at the rudimentary level and are not implemented in practice. This practically makes it impossible to tax the companies which are doing business in Serbia but are not registered (branches, companies) and, on the other hand, creates much confusion with regard to the taxation of the companies which are willing to pay tax on the income obtained by doing business in Serbia.

Action Points:

- Rules on the taxation of permanent business units should be supplemented and clarified, possibly through a separate rulebook which would specify in detail all aspects of taxation for this specific way of doing business. The Tax Administration should develop an accessible and efficient system for the registration of non-resident companies with permanent business units in Serbia.

Rules on transfer prices

The obligation of preparing the documents on transfer prices is defined in overly broad terms. Serbia is one of the few countries in the world that have imposed the universal obligation on all companies to prepare these documents, irrespective of the transaction value and regardless of whether the rules on transfer prices have an impact on the total amount of taxable income at the level of the group (primarily for transactions between related parties in Serbia) or not. For the companies in Serbia this means that they are imposed additional and unnecessary costs for preparing these documents. On the other hand, the Tax Administration lacks capacity to review these documents.

Action Points:

- The rules regarding the documents on transfer prices should be changed so that these documents are prepared only for transboundary transactions.

Value Added Tax

Construction related goods and services where tax debtor rules from Article 10, paragraph 2, point 3 of the VAT Law apply to the calculation of VAT

Persons employed in tax, or finance and accounting, sector (in companies which do not have staff who are specifically assigned tax related tasks), lose a lot of time on interpreting the area with which they are not familiar at all, and on determining whether some specific activity in an invoice is deemed to be an activity falling within the construction sector. Besides the fact that currently applicable rules are complicated to apply, there is also an absence of certainty in their application for tax payers. Primary reason for this lies in references to non-tax regulations (regulations on the classification of business activities) which as such do not provide unambiguous answer to whether a specific transaction is de facto a service falling within the construction sector.

Action Points:

- Rulebook on defining goods and services in construction industry for the purposes of identifying tax debt payer for VAT (Official Gazette of RS, No 86/2015) should be repealed and clear implementing rules should be defined.

VAT registration of foreign entities

Newly-introduced legislative solutions for registration of foreign entities for VAT in Serbia created much confusion with regard to whether such entities have the obligation to register for VAT in Serbia and when. The legislative solution is essentially such that foreign entities in Serbia have the obligation to register for VAT even when they do not have any obligation to pay VAT, on one hand, and, on the other hand, they do not have the obligation to register in the cases in which no one is paying VAT (e.g., when a taxable delivery is made to natural persons).

Action Points:

- Rules on registration of foreign entities for VAT in the Law on VAT and implementing rulebooks should be radically changed so that mandatory registration for VAT is present only in cases when the obligation to pay VAT is actually present.

Miscellaneous Tax Issues

Tax treatment of humanitarian aid

Tax treatment of different forms of humanitarian aid is defined in such a way that it actually discourages such aid: the costs of such aid are recognized only in a limited amount and only if formal requirements are met (and these requirements often make it impossible for aid to reach those who would make best use of it). Besides, the companies which provide aid in the form of in-kind goods are forced to pay VAT for such aid; this essentially means that companies bear VAT costs for such aid.

Action Points:

- Tax legislation, primarily the Corporate Income Tax Law and the Law on VAT should be amended in such a way that both the limits which, under applicable legislative solutions, discourage the provision of humanitarian aid are removed, and mechanisms to stimulate the provision of such aid are introduced.

Tax treatment of uncollectible accounts receivable

Tax treatment of so-called uncollectible accounts receivable is very poor at the moment. Tax framework for this kind of receivables is essentially defined in such a way that business operators which suffer a loss due to their inability to collect their accounts receivable are still under obligation to pay tax for these costs. The requirements for recognizing the costs of writing-off the uncollectible accounts receivable were somewhat improved by recent amendments to the Law on Corporate Income Tax, but they are still very poor. Legislative solutions from the Law on Personal Income Tax implicating that personal income tax is payable in some cases of writing-off the claims against natural persons are unreasonable and without a judicial precedent. Finally, with regard to VAT, it is almost impossible to refund the VAT that the suppliers paid for accounts receivable which they cannot collect from their buyers.

Action Points:

- Rules for recognizing the VAT correction in uncollectible accounts receivable should be radically changed so that such correction is allowed in all cases in which it is clearly suspected that the account receivable is uncollectible (jurisprudence offers some quite good solutions). All Law on Personal Income Tax provisions that address the obligation to pay personal income tax when writing-off the claims against natural persons should be repealed.

Foreign Exchange Operations

Paying a price based on non-resident's selling a share in a domestic legal entity

Although relevant legislation (Law on Foreign Exchange Operations, Law on Foreign Investments, etc.) does not impose any restrictions whatsoever, the banks doing business in the Republic of Serbia refer to the NBS Opinion from 2007 (and thus impose restrictions on business operation of foreign investors).

If a non-resident sells a holding in a domestic company (domestic legal person), the relevant payment can be made only in RSD, and that to the non-resident's account in the Republic of Serbia. Foreign investors therefore inevitably incur losses due to exchange rate difference, transaction costs, etc. Besides, their business operation becomes complex and bureaucratized.

When a non-resident sells a holding in a domestic company (domestic legal person), it should be possible that the relevant payment is made in foreign currency and to the non-resident's account abroad. In that case the payment as such would be separate from any tax liability.

Action Points:

- Proper implementation of relevant legislation should be facilitated by allowing direct payment of price to the account abroad.

Recognition of expenses of write-off of receivables

Article 16 of the Corporate Income Tax Law prescribes that expenses from write-off of receivables are recognized for purpose of corporate income tax subject to the condition that the taxpayer, among others, initiates court dispute for purpose of collection of receivables. Paragraph 5 of Article 16 prescribes exception to this general rule for banks so as that the expenses related to write-off of loans will be recognized also if the court dispute has not been initiated, if the bank provides evidence on inability of the debtor to fulfil its obligations, if at least two years have passed from the maturity of the obligations under the loan.

Action points:

- The exception prescribed by paragraph 5 Article 16 should be extended to all other banking operations towards individuals, including the interest and other expenses related to such operations.