Abstract
This paper addresses the topic of how to help Serbian employers fight for our domestic talent with foreign competition, as due to modern technologies, in the better part of our service sector the Serbian workforce has entered the global market. The author adds to this concern the need to transform the Serbian economy from a service provision one to a model centred around high value creation of domestically owned IP. The Serbian creative industry or, to be more precise, its IT sector, is used as the primary field of research, and its own and fiscal policy makers attempts to align the aforementioned two interests are outlined starting from 2018. Based on the developments so far the author proposes a set of tax measures aimed at facilitating the transition of the current Serbian economy into a 4.0 format, wherein the fight to maintain Serbian talent in Serbia and within Serbian employers plays a crucial role.

Keywords: IT, research and development, human capital, intellectual property, tax

Sažetak
Ovaj rad se bavi pitanjem na koji način pomoći srpskim poslodavcima u borbi za našu domaću radnu snagu sa stranom konkurencijom, imajući u vidu to da je, usled primene modernih tehnologija, ona u većem delu našeg uslužnog sektora privrede postala deo globalnog tržišta rada. Autor dodaje navedenom izazovu i potrebu da se srpska privreda transformiše iz modela koji je prevashodno sadržan u pružanju usluga, na onaj zasnovan na stvaranju veće vrednosti kroz razvoj intelektualne svojine u domaćem vlasništvu. Srpska kreativna industrija ili, to je preciznije, njen IT sektor, uzeti su kao primarno polje istraživanja, gde su napori da se usklađe prethodno navedena dva interesa očekivani još od 2018. godine. Na osnovu postojećeg stanja autor predlaže set poreskih mera kojima bi se osigurao učinkoviti prelaz na model 4.0, pri čemu se potreba da se podrži srpski talent i održavaju u Srbiji i to kod srpskih poslodavaca igra ključnu ulogu.

Ključne reči: IT, istraživanje i razvoj, ljudski kapital, intelektualna svojina, porez
Introduction – the growing pains of the Serbian economy and the emergence of a new crucial issue: the lack of human capital

The Serbian tax policy until 2018 rested on the premise that it was desirable to reduce the employers’ labour costs by virtue of tax incentives, where the intention of the legislator was, almost without exception, to have the entire amount of the incentive benefit the employer and not affect the amount of net earnings of the employees [13]. Namely, comparative research shows that employees bear between 66% [14, pp. 364-367] and 80% of the costs of taxes and social security contributions on their wages [11]. Thus, increasing taxes and mandatory social security contributions will inevitably lead to a drop in the net income of employees. On the other hand, the lowering of the fiscal burden on employment income does not have to have the opposite effect as the employer may be in the position to keep all of the benefits of such a measure, without passing even a portion of them to the employees, particularly if legal provisions are tailored in such a way as to ensure the described result.

Such a conclusion can be derived by looking at the explanatory memoranda for the proposed measures that led to the decrease of the fiscal burden on wages in Serbia.

However, in one particular sector of the Serbian economy, namely its creative sector or, to be more precise, its IT sector, a problem emerged that could not be resolved by a simple reduction of the labour costs for the employer. Namely, people employed in the creative sector of the economy expect to be highly paid for their work, particularly considering that there is a high global demand for them, that is, that these persons can easily and quickly find employment and income anywhere in the world. Unlike the generally accepted notion of our legislators that the key issue in Serbia is unemployment and the lack of investment, and that these two need to be resolved first, while employee wage levels can be taken care of at a later stage, the Serbian IT sector was faced with the problem of securing the workforce it needs to survive and continue to grow. The above problem was further augmented by the fact that the Serbian IT sector competed for the Serbian workforce with competitors from all over the world, where this was not linked only to migratory flows (people leaving the country), but increasingly with foreign competitors managing to find their place in the Serbian labour market itself without establishing any business presence in its territory (the so called remote work which will be discussed in more detail later).

| Explanation for the amendments to the Law on Personal Income Tax |
|---------------------------------------------------------------|
| **2014** | **2015** | **2017** |
| “The reasons for enacting this law are the need to create the setting for investment inflow, employment, and economic growth, and provide more favourable conditions for doing business by reducing the burden on businesses, as a necessary part of implementing a comprehensive reform of the business environment. In this regard, a new tax relief for hiring staff is aimed at eliminating the grey zone in employment and transferring it to the legal sphere. This measure is a part of the ongoing process of encouraging lawful employment and, thus, improving the status of unemployed persons and those who work but are not registered for mandatory social insurance. This measure is a continuation of the business environment improvement measures aimed at reducing the risk and cost of doing business in the Republic of Serbia.” [5, p. 3] | “The reasons for enacting this law are the need to create the setting for investment inflow, employment, and economic growth, and provide more favourable conditions for doing business by reducing the burden on businesses, as a necessary part of implementing a comprehensive reform of the business environment. In this regard, a new tax relief for hiring staff is aimed at eliminating the grey zone in employment and transferring it to the legal sphere. This measure is a part of the ongoing process of encouraging lawful employment and, thus, improving the status of unemployed persons and those who work but are not registered for mandatory social insurance. This measure is a continuation of the business environment improvement measures aimed at reducing the risk and cost of doing business in the Republic of Serbia.” | “The reasons for enacting this law are the need to create the setting for investment inflow, employment, and economic growth, and provide more favourable conditions for doing business by reducing the burden on businesses, as a necessary part of implementing a comprehensive reform of the business environment. In this regard, the extension of the present tax relief for hiring new staff that expires on 31 December 2017 is proposed together with a new tax relief for youth employment through starting own business …” [6, p. 16] |
| “These measures are part of the ongoing process of encouraging lawful employment and, thus, improving the status of unemployed persons and those who work but are not registered for mandatory social insurance. The aim of the new proposed measure is to boost entrepreneurship and remove one of the key obstacles to starting and running a business through tax exemption … This measure is a continuation of the business environment improvement measures aimed at reducing the risk and cost of doing business in the Republic of Serbia.” [7, p. 16] | |
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That is why the Serbian IT sector had to find a solution for providing their staff with the highest possible wages under the most favourable conditions for employers. In other words, in the case of the IT sector, the primary issue that emerged was ensuring adequate earnings for the workforce, while the issue of employer’s costs was secondary (but not irrelevant). After initially being most prevalent in the Serbian IT sector, it should be noted that the problem described above is nowadays also increasingly present in an ever growing number of segments of the Serbian economy. In other words, in addition to investments and reducing unemployment, the Serbian economy, and thus Serbian policy makers have to add to the equation a new element – how to ensure that the Serbian workforce is compensated in the amount which will at the very least slow down the outflow of human capital from the country, or to be more precise, from the Serbian employers. To be cynical to a point by caring almost exclusively about the interests of the Serbian employers our policy (although the blame is not exclusive) has resulted in the situation where they are losing their capability to maintain their status of employers and they are increasingly in the position that they have no one to employ.

From bogus self-employment to realizing the need for facilitating the transition to a new business model

Until 2019 the issue of achieving the optimal remuneration for the workforce in Serbia was resolved by relying on something that could be called an abuse of the presumptive taxation of personal income by concealing the relationship that is substantially one of employment by service contracts with seemingly independent service providers. In other words, employers did not enter into employment contracts with their workforce, although their engagement had all the characteristics of employment (so called bogus self-employment), but the workforce appeared in the role of independent sole proprietors who provided services to their employers on the basis of service contracts, where tax liabilities and, more importantly, liabilities for mandatory social insurance contributions for the fees received were assessed on the presumptive base in accordance with the legislation governing taxation of income from self-employment [13].

The opportunity to resolve the above described problem of the abuse of presumptive taxation by the amendments to taxation laws in late 2018 was passed, but

| Explanation for the amendments to the Law on Mandatory Social Insurance Contributions | 2014 | 2015 | 2017 |
|---|---|---|---|
| “In addition, the reasons for enacting this law are the need to create the setting for investment inflow, employment, and economic growth, and provide more favourable conditions for doing business by reducing the burden on businesses, as a necessary part of implementing a comprehensive reform of the business environment. In this regard, the proposed new relief for hiring new staff is aimed at eliminating the grey zone of employment and transferring it to the legal sphere. This measure encourages lawful employment and, thus, improving the status of unemployed persons and those who work but are not registered for mandatory social insurance. This measure is one of the business environment improvement measures aimed at reducing the risk and cost of doing business in the Republic of Serbia.” [8, p. 3] | “The reasons for enacting this law are the need to create the setting for investment inflow, employment, and economic growth, and provide more favourable conditions for doing business by reducing the burden on businesses, as a necessary part of implementing a comprehensive reform of the business environment. In this regard, the proposed new relief for hiring new staff is aimed at eliminating the grey zone of employment and transferring it to the legal sphere. This measure is a part of the ongoing process of encouraging lawful employment and, thus, improving the status of unemployed persons and those who work but are not registered for mandatory social insurance. This measure is a continuation of the business environment improvement measures aimed at reducing the risk and cost of doing business in the Republic of Serbia.” [9, p. 4] | “The reasons for enacting this law are the need to create the setting for investment inflow, employment, and economic growth, and provide more favourable conditions for doing business by reducing the burden on businesses, as a necessary part of implementing a comprehensive reform of the business environment. In this regard, the extension of the present relief for hiring new staff that expires on 31 December 2017 is proposed together with a new relief for youth employment when they start their own business by exempting them from payment of social insurance contributions (and taxes) in the first years of doing business (in the year of establishing the business and in the following year). These measures are a part of the ongoing process of encouraging lawful employment and, thus, improving the status of unemployed persons and those who work but are not registered for mandatory social insurance. The aim of the new proposed measure is to boost entrepreneurship and remove one of the key obstacles to starting and running a business through exemption from contributions. This measure would result in reducing the number of young people working in the grey economy, boost the young people’s entrepreneurial spirit and participation in the economy without an actual burden on the budget.” [10, p. 6] |
two very important measures were introduced into our tax system at the time. These are the provisions of Article 22d of the Law on Corporate Income Tax, which doubled the amount of deductible research and development costs [1], and Article 25b of the same Law, which provides for the effective corporate income tax rate of 3% (instead of the general rate of 15%) in the case of the income derived from intellectual property created in Serbia [2].

The above-mentioned incentives provided in the Law on Corporate Income Tax aimed to ensure the most favourable tax burden on income generated by the Serbian creative industry, but not only of this sector of the Serbian economy, but also other businesses that create significant added value (by newly created intellectual property) and direct them towards research and development activities.

However, immediately upon their introduction, it became clear that the majority of the Serbian IT sector, as well as the majority of our economy as a whole, is primarily involved in the global flows as a sub-contractor, that is, its added value is based on the services rendered to foreign principals, and not on the newly created intellectual property. This business model, the service provider or sub-contractor model, generates far less added value, and at the same time is fundamentally conditioned upon labour costs, which are the key component of its profit. That is why the incentives introduced in the area of corporate income tax in late 2018 had a limited effect, as their full utilization requires a change of the business model of a large number of Serbian businesses.

In 2019, the problem of abuse of presumptive taxation was mainly resolved by the independence test accompanied by a three-year transitional solution [18], the basic aim of which was to bring in the workforce from hidden to formal employment, while preserving both the total employer’s cost and net earnings of the newly employed person in the amount from the previous regime, through to and inclusive of 2022. These measures were accompanied by general amnesty under which it is forbidden to question sole traders’ independence and the nature of their income in the period prior to introduction of the independence test.

During the debate on the amendments to the tax legislation in late 2019, another very significant problem was identified. Namely, there was a situation gaining momentum, where persons living and working in Serbia were hired by foreign principals to provide certain services, and for a certain number of them, the relationship with foreign principals had all the features of employment (remote work). These persons, in part, carried out their business activity as registered sole traders, so in the case of those who failed or believed they failed the independence test, the newly adopted legislation meant a significantly higher tax burden on income generated from dependent relationships. However, it is their very case that shows that adopting the independence test was fully justified.

Namely, without the independence test, i.e. allowing the abuse of presumptive taxation in the case of a relationship with foreign principals, Serbia would actually subsidize foreign employers, enabling them to be more competitive in the Serbian market than local employers who chose to enter into a formal employment contract with their employees, while such foreign employers in the Serbian territory would not have any presence. In other words, such a form of a working engagement is a direct threat to the local economy – domestic employers, all at the Serbian taxpayers’ cost including within their number, of course, local businesses. Therefore, the Serbian economy is funding its own harm. Moreover, by allowing remote work, where the employee, as a rule, relies on his/her own equipment and acquired knowledge and where the opportunity for further development and acquiring new skills is very much limited due to the manner in which the work is performed, on a long term basis Serbia is losing out not only on new technology and investment, but also on the competitiveness of its workforce.

The largest number of persons who failed or believed that they failed the test of independence in the relationship with foreign employers, and did not want to or could not find jobs with Serbian employers, established single member limited liability companies in which they were employed, usually as the only employee, to continue doing business with foreign principals, and, at the same time, benefit from the introduced transitional regime.

Although the introduction of the independence test was deemed by many in the Serbian public discourse as the undertaker of the Serbian IT sector, research conducted by this author shows that the number of terminated sole
proprietorships under relevant IT sector activity codes almost completely coincided with the number of the newly employed in this very sector.

Furthermore, in 2020, computer programming, under the conditions of COVID-19 pandemic, still boasts an 8.5% growth rate. In comparison with 2019, when the export of EUR 506,252,813 was recorded, in 2020 the value of export in computer programming amounted to EUR 549,269,867 (53.6% of the total IT export), while in 2020 the entire Serbian IT sector had the total export growth of 12%.

On the other hand, the transition regime introduced together with the independence test in essence enabled a very smooth transition of a large number of people from bogus self-employment into employment and indeed does leave us with the question what to do once it expires on 31 December 2022.

COVID-19 and the freelancing problem

Most recently, in 2021 the problem of so-called freelancers appeared in Serbia. These are persons who entered into relationship with foreign principals without any registration whatsoever (registered as e.g. sole proprietors) or payment of any taxes in Serbia where the issue of damage to the Serbian tax revenue, as well as the Serbian local economy, i.e. employers, appeared on a much broader scale than with the independence test. The course of events relating to taxation of freelancers, the issue not at all specific for Serbia (e.g. in March 2021 Pakistani tax administration discovered 75,000 people generating almost EUR 350 million only through the Payoneer platform, without reporting any taxable income from abroad [12], has shown that the awareness of tax duty, and in particular the awareness of the need to pay contributions for social security is on an exceptionally low level, not only in the freelancer community, but in much of the Serbian society that showed great understanding for their position. Contrary to the independence test introduction, where the opposition was related to social media and mass media, taxation of freelancers resulted in more serious protests in our streets.

We are in Serbia now realizing that our new digital economy has not only enabled enterprises to generate profits in market jurisdictions without having any physical presence in them. Today they are capable of creating and providing their products/services without having a permanent place of business within the states where these products/services have been created or maintained.

In the case of foreign remote workers who are engaged outside of a formalistic employment relationship, the enterprise will not have any administrative obligations to the state of the worker to withhold and pay individual income taxes and perhaps even more importantly mandatory social security contributions in respect of the workers income. The worker, who can easily pose as an unregistered freelancer, is, in theory, expected to meet his or her own tax and social security contributions liabilities. The enterprise may easily be tempted to offer to the worker as compensation an amount which would not be acceptable or competitive in case taxes and social security contributions will be duly paid, but which is agreed upon by the worker who is ready not to report his or her income, wherein some payment platforms may, perhaps unwillingly, aid in such tax avoidance being undetected by his or her tax authorities. Thus, not only are the cost of the employment relationship avoided in purely labour law terms (sick leave, various compensations, bonuses, responsibilities in case of termination of the employment), but the model has the potential to enable a significant cost reduction at the expense of individual income taxes and mandatory social security contributions revenues of the work state [3, p. 81], [20, pp. 10-11].

The revenues from individual income taxes and mandatory social security contributions are not the only ones threatened. The described digital economy model may easily endanger the fiscal revenues collected from domestic enterprises. Namely, domestic enterprises cannot avoid paying or, to be more precise, withholding individual income taxes and mandatory social security contributions from their local workforce compensations. If they are to compete for local talent with foreign employers who are able to provide more competitive remunerations, wherein this competitiveness has been enabled by virtue of essentially tax avoidance, then their development and even survivability may be questioned as they may not be able to find the employees they need. This conclusion may
hold true even in countries which have an abundance of young workforce, as a rule developing countries, due to the fact that the digital economy will target those who possess adequate education or skills of which there is always a deficit. In other words, allowing remote work in the state of work may provide short-term benefits in terms of higher income of some individuals (at the cost of avoiding local taxes and mandatory social security contributions), but may threaten the development of the local digital economy as independent freelancers will never arise to this level [21].

The argument in favour of remote work may be linked to the prevention of the brain drain, a problem which is plaguing not only Serbia, but an increasing number of countries worldwide [14, pp. 364-367]. Namely, finding work with foreign employer on-line enables individuals to remain in their native states, enjoy a more affluent life style in them for the same amount of money as compared to the one they would have had they emigrated. However, this is done at the cost to the development potential of domestic companies and, in case of the tax avoidance element in the equation, by the foreign employer being effectively subsidized by domestic taxpayers who are not in the position to avoid their obligations. Thus we can conclude that this stemming of the brain drain tide is essentially paid for locally with costs, potentially, particularly in the long term, outweighing the benefits.

Determining the principle goals

The global COVID-19 pandemic started a bit before the introduction of the independence test in the Serbian legislation and it halted normal economic activities. Although it slowed down development of the Serbian economy, it nevertheless gave us precious time needed to get a thorough insight into the steps that will, on a mid-term basis, provide for continuation and possible acceleration of its growth. As we have seen from the previous historic review it was during the COVID-19 pandemic that our society came to be aware of the remote work and freelancing problem. Now we should attempt to set the framework in which future taxation measures should move in order to achieve the best possible results for both the economy and society as a whole, with the least possible cost for the Serbian budget.

a) It is necessary to transition from the predominantly service-based business model to the generation of original valuable intellectual property [4].

This transition is needed, not only because it provides for much higher income for the businesses and their employees, but consequently for the public revenue of the Republic of Serbia, the same public revenue that will suffer increased pressure due to extraordinary loans taken during the COVID-19 pandemic, i.e. due to the need to return our public finances into the pre-pandemic framework. In other words, the change of business model is aimed at the elevation of the taxable base and at ensuring a future sustainable growth of Serbian public revenues.

Nevertheless, the described transition is, to a great extent, also a prerequisite for the survival of the Serbian economy as it is. Namely, as it has already been said, the business model of service providers or subcontractors mainly depends on the amount of cost for the workforce. The income of the Serbian workforce in the area of IT, but also in an increasing number of sectors, has long exceeded the amounts that may make them competitive in comparison to e.g. Ukrainian, Philippine, Indian or IT economies of some African countries which are increasingly rising in relevance. To put it simply, the business model based on cheap workforce is either no longer possible in Serbia or will not be possible very soon, even if the state renounces all of its revenue. In case the Serbian employers start reducing salaries of their staff, this will result in accelerated emigration of this workforce, while if they fail to reduce their labour cost driven prices, they will no longer be able to find clients in the increasingly competitive global market.

b) It is necessary to enable the Serbian economy to generate new jobs that will be offered, under competitive terms, to the local workforce. At the same time, generating new jobs is the only way to preserve the current volume of the workforce in the Serbian economy.
Having in mind the pressure exerted on the cost of labour, the Serbian economy can generate new jobs only in the segment that is not so dependent on the cost of labour, namely in the business model crucially linked to research and development, i.e. activities leading to the production of new, valuable intellectual property. If the Serbian economy fails to generate new jobs, and even more importantly recruit new staff successfully, this will result in stagnation of the current forms of business and gradual loss of what has already been achieved.

c) It is necessary to help the Serbian economy to wrestle with the competition of foreign employers, be that those who attract our workforce to emigrate or those hiring them directly from abroad as freelancers, triggering thus a series of adverse consequences that affect both the Serbian economy and Serbian society as a whole.

In order to reduce the migratory trends, we need several more years of significant economic growth to provide for not only the income competitive to what one can make in other countries, but also overall more attractive social environment that also is a factor in the workforce decisions to emigrate. The increase in net salaries of employees in the Serbian economy will make the freelance arrangements with our tax residents unprofitable either for themselves (remuneration will be too low), or for their principals (due to demand for excessively higher pay), which will eventually reduce the pressure that we currently have to come in Serbia. Images of tax payers’ bursts of dissatisfaction, unjustified to a great degree, seen during the protests of freelancers indicate the need to introduce certain measures of primarily psychological nature, whereby our most promising workforce, without which there will be no economic growth or survival of our economy in the long term, could be convinced that Serbia is a country of the future.

All three items mentioned above require well considered mid-term plan for a period of at least 5 years. The Serbian economy has to initiate its next transformation in the manner that will enable at least mid-term planning, agreement with decision makers on the key elements of this transformation, all of this with increasing level of social consensus about the agreed terms and direction of the road ahead.

From the viewpoint of our region, Serbia has a chance to take the champion’s role in the 4.0 economy. All countries in our neighbourhood still try to maintain their market positions on the basis of the cheap workforce model (e.g. Bulgaria). Besides, some of them, due to political pressure, very serious general social circumstances or misunderstanding of true challenges of some forms of business, even resort to support of the freelance models of domestic workforce engagement with foreign principals (Ukraine, Macedonia), although these business models prevent the development of domestic economy since they deprive it of the acutely needed workforce, i.e. prevent its conglomeration and exploitation of its overall creative potential. Conversely, Croatia, supported by the EU funds, goes in the opposite direction and recognizes the importance of research and development, i.e. the change of the business model to provide for the future of its IT sector and development of its economy in general.

A plea for short-term solutions

Partial or short-term measures are always less attractive, at least from a theoretical perspective, than broad reform sweeps resulting in fundamental overhauls of tax legislation, overhauls which should at the very least aim to ensure a neutral and fair tax system. However, when debating tax policy one must take into consideration the reality of the world we live in. When it comes to Serbia, a general reform of the Serbian system of direct taxation (our corporate income tax, personal income tax and most importantly our mandatory social security insurance and corresponding contributions) would require under the most optimistic scenarios 3 years in the minimum. Namely, such a step warrants not only in-depth research and debate, but also necessitates that we wait for the transformation of the Serbian Tax Administration to take place, as this crucial element of our civil service, an element without which no tax reform can hope to be successful, is not in a position to withstand the pressures of such a tectonic change in our system that would have to result from the unavoidable abandonment of the cedular system of personal income
taxation. On the other hand, the Serbian economy cannot wait another 3 years and we need to use the respite provided to us by the COVID-19 epidemic to introduce measures which will ensure that we have a vibrant economy at the time when our system is ready to endure a fundamental tax reform. As a result, while the debate on the general outline of our future tax reform should start now, we must simultaneously introduce measures which will attempt to buy us the time we need.

The proposals we present in the following part of this paper have been designed to provide for the successful transformation and, thus, the future of the Serbian economy.

a) Incentives for investment in R& D at the level of human capital

As we have stated previously in this article, a large number of Serbian companies have found their place in the global economy as service providers on the basis of the low costs of labour and have had so far little incentive to initiate the development of their own products, due to a high cost of research and development. Since we would like to motivate companies to change their business model towards activities with higher added value, it is necessary to introduce an earmarked incentive for activities that we want to see expand, primarily research and development. The objective of this measure is to motivate companies to pursue activities that generate higher income, in order to increase the profits, whereby GDP, export and, eventually tax revenue, would also be increased.

Thus we propose a reduction (through relief of the duty of the employer to pay assessed and withheld taxes and contributions) of the tax on salaries and contributions for mandatory social security insurance in the amount of e.g. 70% for employees working on research and development (R&D) projects.

The mechanisms of implementation, monitoring and control of such an incentive are already in place, since this is a combination of two already existing incentives: for qualified new employees under the transitional regime supporting the independence test and the double R&D deduction from Art. 22g of the Law on Corporate Income Tax.

The negative effect of this incentive on the budget revenue would be significantly reduced due to the fact that a part of employees that would be entitled to using this new incentive would overlap with the number of employees that would, with expiry of the term of the transitional regime for qualified new recruits, stop using the incentive which supported the introduction of the independence test.

b) Continuation of the use of transitional regime supporting the introduction of the independence test under special terms

Companies with less than 50 employees, particularly in the Serbian IT sector, will suffer most with expiry of the transitional regime accompanying the independence test. These are, first of all, companies that are locally owned, and companies that enabled development of the IT and other innovative sectors in smaller communities, beyond three largest urban centres in the country. The lack of resources limits the capacity of small companies for change that is available to larger companies, particularly in affordability of hiring expert advisory support necessary for these undertakings. Unfortunately, these companies have not clearly received the message which the introduction of the corporate income tax incentives from late 2018 should have sent, and they are not sufficiently aware of the absolute necessity to change their current service provider business model.

We suggest that all Serbian IT companies with up to 50 employees on 31 December 2021 be allowed to continue to use the transitional regime referred to in Article 21ž of the Personal Income Tax Law, and Article 45d of the Law on Mandatory Contributions for Social Insurance for another 3 years (ending with 31 December 2025). This entitlement would be applicable only to those qualified employees for which the entitlement from the transitional regime is already in use, where the entitlement would be extended for three more years, but with gradual reduction of the incentive. The right can be claimed only with the employer where the qualified employee was employed on 01 January 2023 without the right to carry the entitlement over to another employer. All employers using the incentive would be required to fulfil their duty relating to maintaining the number of
employees even during the extended duration of the incentive for qualified employees.

This incentive does not require any additional budgetary resources, since this is only a continuation of the already existing regime. Moreover, this will result in the rise of budget revenue due to a gradual fall of the incentive amount.

A combination of the two previously described measures would accomplish several goals:

- A reduction of the fiscal burden on wages of employees engaged in R&D activities, together with quite generous treatment offered at the level of corporate income taxation, would allow Serbian companies to not only have a favourable tax environment in respect of changing their business model, but would be in the position to compete on equal or even more preferential terms with foreign companies for Serbian talent.
- The continuation of the transition regime which supported the introduction of the independence test for only those companies which employ up to 50 people would drive large market participants to the change in the business model, while at the same time providing more breathing space for the smaller ones. It would also allow those who enter into the transition of their business model to create new jobs, jobs which will in the future be filled by the employees of those smaller companies which fail to survive the termination of even the prolonged transition regime.

At this point in time 25,000 people in Serbia enjoy the benefits of the transitional regime which followed the independence test. Not all of them are engaged in the Serbian IT sector which today has approximately 20,000 employees. Half of all employees in the Serbian IT sector are currently employed by companies which have a workforce of under 50. Thus, even with a carve-out for these companies, the ending of the transitional regime on 31 December 2022 will result in the benefits of the incentive no longer being available for at the minimum 15,000 employees. Thus, only if the Serbian economy manages to engage more than 15,000 people in R&D projects, wherein these individuals would be enjoying the same privileges now offered by the incentives provided under the transitional regime which supported the introduction of the independence test, would the Serbian fiscus be in the position to allocate more funds than it is doing at this very moment. And, if such a number of people is truly engaged in R&D projects in Serbia, this figure would only confirm the success of the introduced measures, as the transition of the business model would have been successfully initiated.

c) The provision of a tax-friendly environment for the corporatization of IP in Serbia

Experience shows that Serbian businesses have been quite callous when it comes to their IP. In some cases long existing companies have seen their IP being transferred somewhere abroad pursuant to their privatization. Innovative companies have not yet realized the value of their IP and the dire need for its protection and corporatization, all in order to maximise their potential value and long-term benefits from such assets.

If we are to transition to a new business model we must provide Serbian companies with an opportunity to declare, protect and dispose of their IP in the most efficient manner. Unfortunately, our current system is far from such a standard.

Namely, under current Serbian legislation in case a resident individual, or a company, would like to declare, protect and contribute already created IP into the capital of a Serbian company, such a step may require significant funds. For example, if the IP in question was created at a cost of EUR 100,000 (one should bear in mind that in a large number of cases Serbian taxpayers are not in the position to substantiate any cost related to the R&D which resulted in the creation of IP as they have simply not kept any records of such costs), while its current fair market value is 1,000,000 EUR, in case such IP was contributed into the capital of a legal entity (Serbian or foreign), the tax bill emanating from this transaction would amount to 15% of the capital gain seen as the difference between the cost of creating the IP and its current market value. It is not difficult to see that such a tax burden is an excellent motivator for Serbian residents to try and avoid contributing
IP they created into the capital of their companies. On the other hand, if IP is not corporatized it cannot be properly protected, managed and exploited. This is just pure common sense.

Therefore, we would propose two parallel measures. Firstly, the contribution of IP into the capital of Serbian companies should be exempt from capital gains taxation. In other words, IP business reorganizations should be tax free.

Furthermore, the companies into whom the IP has been contributed should be allowed to use the fair market value of the assets at the time of contribution as their acquisition value. This second measure could be supported by a measure which we could name an IP repatriation amnesty.

Namely, we know that some of the IP created by Serbian companies in the past has been transferred abroad during the privatization process, without any compensation paid to them. In addition, these same companies were placed in the position to pay royalties for the right to use the IP they themselves created. In some business sectors we also see the prevalence of structures wherein although Serbian companies and their employees are the only ones contributing to the creation of IP, they are treated and remunerated as simple service providers with the most significant part of the overall income from such IP being generated by their related foreign entities which have no economic substance.

The Serbian Tax Administration was not capable of effectively combating both of the described structures. Furthermore, its ability to do so in the near future may be questioned. Thus, on the basis of such a state of affairs we propose an amnesty for previous periods for all IP contributed into the capital of Serbian companies within e.g. the calendar 2022. In essence, if the IP was repatriated to Serbia, provided that it still has material value, the Serbian Tax Administration would not challenge and assess additional tax liabilities and penalties with respect to the initial removal of IP from the Serbian entity, or the subsequent royalty payments made to the new holder of the IP. In addition, the profits of the Serbian entities posing as mere service providers would not be increased by virtue of the application of transfer pricing provisions so as to bring their previous results in line with their true role in the creation of the IP.

Although one may argue that the proposed measure gratifies those who have avoided Serbian taxes in the past, it is inspired by the same arguments which were behind the US legislation on the beneficial tax treatment of repatriated foreign earnings of US corporations and takes into account the exurban costs, as well as limited success potential of using tax audits in order to remedy past problems in this area.

Reverting to ancient Romans for inspiration instead of a conclusion

As an active participant in most Serbian tax policy debates regarding those segments of its economy which are and will continue to be the drivers of our economic growth the author is tempted to conclude this paper with a rather bold proposal.

Namely, the Serbian creative industry is quickly reaching the economic relevance of our agricultural sector, while more than half of all employees in this sector are between 25 and 40 years of age [17, p. 530]. Serbia will win the battle of the future provided it is capable of keeping at least a portion of its young and bright. If in addition to maintaining its talent pool it manages to draw in foreign talent success is ensured. Alas, our young and bright often have limited trust that their future is here. The Serbian society, including its tax system, must make an additional effort to convince them otherwise.

Thus, instead of a conclusion, we propose that all resident taxpayers with college or university education who are under the age of 40 be exempt from the obligation to pay the complementary annual individual income tax which is due in cases one’s annual income is above the threshold of three average annual salaries paid in Serbia in the respective year. These individuals have firstly deserved this exemption as they invested, by virtue of education, in gaining the skills needed by our economy, wherein this investment postponed them being able to generate income. Secondly, the annual individual income tax is a grossly unfair tax levied at essentially at the remnants of the Serbian middle class and not, as it is the common
misconception, wealthiest sections of our society [16, pp. 80-82]. In other words, by virtue of this exemption we would be investing in the rebirth of our middle class. The measure is also value oriented, as it promotes and awards education, while it tends to the most qualified, those whose immigration renders the highest cost for our society. Finally, by requesting all those who would emigrate before the age of 50 to repay (with interest) any benefits enjoyed from this incentive, we would be confirming the merit basis of the proposal.

This measure is not discriminatory towards those older than 40, as the preservation of the young population is in their vital interest. For example, if nobody is left to fund the pensions system, pensions will not be paid, regardless of the existence of entitlement. Without those paying the contributions and filling the budget by the way of taxes, pure legal entitlements to healthcare or retirement income are worth less than the paper they are written on.

In times of desperation in the Roman Republic extraordinary powers were granted to the Consuls by the decision of the Senate called in Latin senatus consultum ultimum. The majestic formula of this decree was Dent operam consules ne quid detrimenti res publica capia – and let the Consuls take care that the Republic suffers no harm. Our Republic is in peril. And it needs extraordinary measures in order to have a chance of survival. Our battle is on the demographic front and in trying to maintain our home grown talent in the country with our employers. And as in Roman times when the legions were facing dire need the veterans’ stepped into the front line, while the young soldiers were sent to the back lines. The future was to be preserved by the sacrifice of those who were not to be its promoters. Thus, our proposal may be seen as removing our young and the best, who have done all that we as a society have asked them to do, from the front fiscal lines. And in doing so we would not only be doing the right thing when it comes to the future, we would (as the author is beyond the age when he would be able to benefit from his own proposal) be doing what is just.

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Svetislav V. Kostić

Dr Svetislav V. Kostić, LL.M is an Associate Professor at the University of Belgrade Faculty of Law teaching at both undergraduate and graduate levels. Until 2016 Dr Kostić also held the post of a Director with Deloitte Serbia Tax Services. He is one of the founders of the Serbian branch of the International Fiscal Association, currently in the capacity as its Secretary General. He is a member of the Practice Council of the New York University School of Law LL.M in International Taxation and one of the Vice Chairs of the IFA Europe Region.