Chapter 25

Serbia: Tax Policy as Part of National Economic Governance

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Abstract

This chapter analyses three specific characteristics of Serbian tax law and policy: tax competition, the prohibition of discrimination, and the prohibition of the abuse of law. First, we analyse the extent to which the Serbian legislative and executive powers resort to tax competition. Tax competition, a form of regulatory competition, exists when governments reduce fiscal burdens to encourage the inflow of productive resources or discourage their exodus. Non-discrimination is one of the fundamental principles of international tax treaty law, which may be found in hundreds of bilateral double taxation treaties that are currently being applied globally. This principle is articulated in most tax treaties concluded by the Republic of Serbia. Finally, this chapter analyses the general anti-abuse rule, such as the one incorporated in the EU Anti-Tax Avoidance Directive, which is the 'minimum standard' and does not preclude the application of domestic or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases. Notably, in the Serbian legal system, the prohibition of the abuse of law is not articulated as a general principle of tax law. Instead, the legislature introduced the principle of facticity. Both administrative and judicial case law related to the application of the principles of facticity are limited.

Keywords: *taxation, Serbia, European integrations, abuse of law, tax competition, principle of non-discrimination*

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1. Introduction

The fulfilment of economic criteria is a key requirement for membership in the European Union (EU), as set out in the Copenhagen criteria; this implies the existence of functioning market economy with the capacity to withstand competitive pressure inside the single market. Following the pre-accession experience of countries in Central and Eastern Europe, which joined the EU in 2004 and 2007, the EU defined its enlargement policy based on the Stabilization and Association Agreements (SAAs) it made with each Southeast European country.

Serbia's EU accession process lasts for almost 20 years, during which the country advanced from a potential candidate to a candidate. Under the SAA, Serbia and the EU agreed to cooperate in the field of taxation, including through measures to further reform Serbia's fiscal system and restructure tax administration to ensure the effectiveness of tax collection and fight fiscal fraud.[1] Such cooperation must take due account of priority areas related to EU *acquis* in the field of taxation and in the fight against harmful tax competition. Cooperation must also be geared toward enhancing transparency and fighting corruption; thus, relevant measures are also related to information exchanges between EU Member States to prevent tax fraud, evasion, and avoidance.[2] As of 2015, all candidate countries and potential candidates submitted their annual economic reform programs to the European Commission. These programs are expanded versions of the previous Pre-Accession Economic Programmes for candidate countries and include medium-term macroeconomic projections (including GDP growth, inflation, trade balance, and capital flows), budgetary plans for the next three years, and structural reform agendas.

In this chapter, three specific characteristics of the Serbian tax law and policy shall be analyzed: tax competition, the prohibition of discrimination, and the prohibition of the abuse of law. We shall first analyze to what extent the Serbian legislative and executive powers resort to tax competition methods. Tax competition, as a form of regulatory competition, exists when governments reduce fiscal burdens to encourage inflows of productive resources or discourage the exodus of those resources.[3] Non-discrimination is one of the fundamental principles of international tax treaty law, which may be found in hundreds of bilateral double taxation treaties (DTTs) now being applied globally. This principle is also articulated in most tax treaties concluded by the Republic of Serbia. In the Serbian legal system, the prohibition of the

1 SAA, Art. 100.

2 SAA, Art. 100.

3 In the context of EU state aid law, prescribing tax rules which give preferential treatment to foreign companies is referred to as 'unfair tax competition'. This concept is meant to strengthen the economy of the 'poaching' state, which grants tax incentives by offering foreign capital attractive tax conditions. In the end, it is by definition a domestic business with domestic employees (e.g. the domestic subsidiary of a foreign company conducting finance or coordination work) which benefits from the tax incentive offered at the expense of the economy and the tax revenue of the other Member State. See: Schön, 1999, pp. 934–935.

abuse of law is not articulated as a general principle of tax law. Instead, the legislator introduced the principle of facticity, which is not being consistently interpreted and applied by administrative bodies and courts.

2. Tax competition

Fiscal policy can be a powerful instrument for attracting foreign investment. However, there is a conflict between the interests of the state, on the one hand, to attract as much investment as possible (a desire to lower the tax burden), and, on the other hand, to raise as many funds as possible to finance public functions (a desire to increase the tax burden). Tax competition is an important indicator of overall competitiveness. For every economy, particularly one with the strategic goal of EU membership, sustainable development is of the utmost importance.[4] The most obvious negative effect of tax competition is a sort of 'race to the bottom', precisely because countries compete to reduce tax rates to create equally attractive business environments that are favourable for foreign investors.[5] Many investors bargain with different governments to obtain the best incentive package, and governments generally fear that investments would be lost if the demanded tax incentive is not provided.[6]

According to surveys published in Serbian economic literature, most foreign investors marked tax incentives in corporate income tax (35.2%) as the most significant and determining factor for investment in Serbia. Subsequently, tax incentives for recruiting new workers (26.1%), tax incentives for exporting enterprises (21.6%), tax incentives for investing in underdeveloped regions (18.2%), tax incentives for investing in certain industries (11.4%), tax incentives for the establishment of small and medium enterprises (9.1%), tax incentives for personal income tax (6.8%), and tax incentives for businesses in free zones (6.8%) were found to contribute to the decision to invest in Serbia.[7]

Financial incentives from the state may be awarded for financing greenfield or brownfield investment projects[8] in the manufacturing sector in line with the Investments Act[9] and the Regulation on Determining the Criteria for Granting Incentives.[10] Applications for financial incentives from the state are submitted to the Development Agency of Serbia by investors – domestic or foreign companies – through a related

4 Marjanović, Domazet and Simović, 2020, p. 971.
5 Marjanović, 2018, p. 96.
6 Marjanović, Domazet and Simović, 2020, p. 973.
7 Marjanović, 2018, p. 99.
8 In brownfield investment project, an investor invests in an already existing facility instead of creating an altogether new set-up as in the case of a greenfield investment.
9 *Official Journal of the Republic of Serbia* 89/2015 and 95/2018.
10 *Official Journal of the Republic of Serbia* 1/2019, 39/2023 and 43/2023.

beneficiary with a seat in the Republic of Serbia. Two main types of incentives can be granted: (i) investments in material and non-material assets, starting from the submission date of the application for incentive granting until the expiration date of the period for the realisation of the investment project and (ii) gross salaries for newly employed persons over a period of two years after the achievement of full employment with the beneficiary of incentive funds. The government prescribed minimum investment amounts in the production sector related to the NUTS region,[11] where the investment project takes place. For example, in the Vojvodina region (in the northern part of Serbia), the minimum number of new employees is 40, and the minimum amount of investment is set at EUR 400,000. In addition, beneficiaries can be granted an increase of up to 30% in eligible investment costs for material and non-material assets. The Government has also adopted the following sector-specific laws: (i) regulation on conditions and methods of attracting direct investments in the food manufacturing business;[12] (ii) regulation on determining the criteria for awarding incentives to attract direct investments in the automation of existing capacities and innovations;[13] and (iii) regulation on conditions and methods of attracting direct investments in the hotel accommodation service sector.[14]

The CITA prescribes a special tax relief for large investments, subject to the fulfilment of the following conditions: (i) investment of over RSD 1 billion (approximately EUR 8 million) in fixed assets which are used for registered business activities (investments in progress are not considered fixed assets in use until activation) and (ii) employment of 100 new employees for an indefinite period of time during the period of investment.[15] Finally, Serbia introduced payroll tax incentives which could not be combined with the financial incentives. Specifically, the employment of persons registered with the National Unemployment Agency for more than six months entitles employers to a sizable relief of taxes paid on net salary from the moment of employment: (i) 1–9 new jobs grants a 65% reduction; (ii) 10–99 new jobs grants a 70% reduction; and (iii) more than 100 new jobs grants a 75% reduction.

3. Prohibition of discrimination

The non-discrimination clause in international tax treaties is widely harmonised, given that countries rely extensively on the OECD Model Tax Convention[16] to draft their bilateral tax treaties. The OECD Model Tax Convention follows the following rule:

11 NUTS stands for 'Nomenclature of Territorial Units for Statistics'.
12 *Official Journal of the Republic of Serbia* 1/2019, 23/2023 and 39/2023.
13 *Official Journal of the Republic of Serbia* 18/2022.
14 *Official Journal of the Republic of Serbia* 33/19, 42/19 and 18/22.
15 CITA, Art. 50a.
16 OECD, 2017.

> The nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is more burdensome than the taxation and connected requirements to which nationals of that other state in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both Contracting States.[17]

The national legal doctrine[18] differentiates the three groups of Serbian DTTs according to the manner in which the non-discrimination principle is formulated. The first includes DTTs which do not contain a provision dedicated to prohibiting discrimination. This group is illustrated by a treaty concluded between the Republic of Serbia and Kuwait.[19] The second group includes DTTs which contain a non-discrimination clause identical or similar to that laid down by the OECD Model Tax Convention. This group of treaties is illustrated by a treaty concluded between the Republic of Serbia and Switzerland.[20] Although certain treaties belonging to this category follow the wording of the OECD Model Tax Convention in their English versions, they depart from it in Serbian.[21] The heterogeneity of this group of treaties is further emphasised by the fact that some of them, such as the treaty concluded between the Republic of Serbia (SFR Yugoslavia) and the Kingdom of Sweden in 1980,[22] lay down non-discrimination clauses which encompass only natural persons and thus exclude legal persons. The third group of treaties encompasses those that prohibit discrimination based on residence and not nationality. This is contained in the DTT between the Republic of Serbia (FR Yugoslavia) and Poland.[23] Serbian legal doctrine explains the residence-based non-discrimination provisions found in several DTTs by the inability to cover persons other than individuals under the term "nationals".[24] This approach is typically found in older DTTs concluded in the SFR Yugoslavia and FR Yugoslavia eras. The more recently concluded Serbian DTTs recognise that residents and non-residents are in different situations and must often be treated differently for tax purposes.

17 OECD, 2017, Art. 24 para. 1.

18 Kostić, 2014, pp. 143–149.

19 Act on ratification of the Agreement on avoidance of double taxation concluded between the FR Yugoslavia and Kuwait, *Official Journal of the FR Yugoslavia* 4/2003.

20 Act on ratification of the Agreement on avoidance of double taxation concluded between the Ministerial Council of the State Union of Serbia and Montenegro and the Swiss Federal Council, *Official Journal of the State Union of Serbia and Montenegro* 11/2005, Art. 24. Please note that this DTT is soon to be amended. In September 2023, the Republic of Serbia and the Swiss Confederation concluded a Protocol on amendments, which is to be ratified by both parties (24 September 2023).

21 Kostić, 2014, p. 145.

22 Act on ratification of the Agreement on avoidance of double taxation concluded between SFR Yugoslavia and Kingdom of Sweden, *Official Journal of the SFR Yugoslavia* 7/81, Art. 23.

23 Act on ratification of the Agreement on avoidance of double taxation concluded between FR Yugoslavia and the Republic of Poland, *Official Journal of the FR Yugoslavia 2/98*, Art. 25.

24 Kostić, 2014, p. 149.

Outside the context of international tax treaties, the issue of discrimination is rarely regulated by Serbian national tax or commercial laws. The Constitution of the Republic of Serbia[25] lays down a general prohibition of discrimination, according to which '(e)veryone shall have the right to equal legal protection, without discrimination' and '(a)ll direct or indirect discrimination based on any grounds, particularly on […] national origin […] shall be prohibited'.[26] The Investments Act[27] prescribes the application of the principle of national treatment to foreign investors as follows: 'Investors who are foreign legal or natural persons, in terms of their investments, enjoy in all equal status and have the same rights and obligations as domestic investors, unless this or other law provides otherwise'.[28] However, the Investments Act also prescribes that investment projects awarded in accordance with international agreements and regulations governing state aid and attracting direct investments, which are in progress, shall continue to be executed in accordance with the regulations by which they were awarded.[29] Finally, the Foreign Trade Act[30] proclaims the principle of the most-favoured nation and the principle of national treatment. The most-favoured-nation treatment is applicable to foreign trade with a state or customs territory to which such treatment has been accorded under an international treaty or by the government's decision.[31] Under the principle of national treatment, foreign goods imported to the territory of the Republic of Serbia shall not be given less favourable treatment than similar domestic goods.[32] However, the application of these principles is conditioned by the existence of an international treaty or a government decision.[33]

4. Abuse of law

In the European civil law legal family, the abuse of law existed for almost a century and a half when it first appeared in the liberal legal order of the second half of the 1800s as an incorrect exercise of subjective rights. EU law also prioritises abuse. The abuse of law is the source of a nearly thirty-year-old jurisprudence of the Court of Justice of the European Union (CJEU) that confirmed the right of the EU and its Member States to oppose the presence of abusive behaviour, even in the absence of a norm that explicitly defines this authority. The main domain

25 *Official Journal of the Republic of Serbia* 98/2006 and 115/2021.
26 Art. 21 of the Constitution of the Republic of Serbia.
27 *Official Journal of the Republic of Serbia* 89/2015 and 95/2018.
28 Art. 7 para. 1 of the Investment Act
29 Art. 44 of the Investment Act.
30 *Official Journal of the Republic of Serbia* 36/2009, 36/2011, 88/2011 and 89/2015.
31 Art. 6 para. 1 of the Foreign Trade Act.
32 Art. 7 para. 1 of the Foreign Trade Act.
33 Art. 6 para. 1 and Art. 7 para. 3 of the Foreign Trade Act.

of the application of *fraus legis* has been tax avoidance; however, one may consider that this abuse of law principle has a potentially vast application in EU law, both in tax-harmonised and tax-non-harmonised areas.[34] Most legal authors consider the principle of the prohibition of abuse of law to be a general principle of EU law rather than an interpretative one. It follows that the general anti-abuse rule, as set out in the directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market (hereinafter: the Anti-Tax Avoidance Directive [ATAD]),[35] which was adopted in 2016, must be seen merely as a partial codification of this general principle as applied to taxation.[36] The ATAD establishes rules against tax avoidance practices that directly affect internal market functioning.[37] The general anti-abuse rule incorporated in the ATAD is the 'minimum standard' and shall not preclude the application of domestic or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases.[38] As indicated in the preamble of the Directive, it is important to ensure that the general anti-abuse rules are applicable in domestic situations within the EU and *vis-à-vis* third countries in a uniform manner so that their scope and results of application in domestic and cross-border situations do not differ.[39] Although full harmonisation would be more optimal, an approximation via a minimum standard is a step forward, particularly in the domain of direct taxation.[40] Given that the harmonisation of Serbian tax rules with EU law is ongoing, the former is yet to be fully aligned with the provisions of the ATAD.

Serbian tax law does not explicitly recognise the abuse of the law principle. Instead, one may rely on the substance over form doctrine prescribed under the Act on Tax Procedure and Tax Administration (ATPTA).[41] The ATPTA lays down the principle of facticity, introduced by amendments to the ATPTA in 2003, as a general principle of the tax procedure.

> Tax facts shall be established based on their economic substance. If a simulated legal transaction is used to conceal a different legal transaction, the base for assessing the tax liability shall be the dissimulated legal transaction. When proceeds and/or assets are acquired illicitly, the Tax Administration shall assess the tax liability in keeping with the law governing the corresponding type of tax.[42]

34 Piantavigna, 2011, p. 135.
35 OJ L 193, 19.7.2016, 1–14.
36 de la Feria, 2020, p. 146.
37 Art. 6 of the Anti-Tax Avoidance Directive.
38 Art. 3 of the Anti-Tax Avoidance Directive.
39 Preamble para. (11) of the Anti-Tax Avoidance Directive.
40 Scherleitner and Korving, 2023, p. 1079.
41 *Official Journal of the Republic of Serbia* 80/2002, 84/2002, 23/2003, 70/2003, 55/2004, 61/2005, 85/2005, 62/2006, 63/2006, 61/2007, 20/2009, 72/2009, 53/2010, 101/2011, 2/2012, 93/2012, 47/2013, 108/2013, 68/2014, 105/2014, 91/2015, 112/2015, 15/2016, 108/2016, 30/2018, 95/2018, 86/2019, 144/2020, 96/2021 and 138/2022.
42 ATPTA, Art. 9.

Other principles of tax procedures enshrined in the ATPTA are the principles of legality, the principle of temporal applicability of tax regulations, the principle of allowing the review of facts, the principle of confidentiality in tax procedure, and the principle of acting in good faith.[43] Although some authors[44] consider the principle of facticity under the ATPTA to be the general anti-avoidance rule in Serbian tax law, the linguistic interpretation of this rule may lead to absurd situations.[45] For example, tax liability may be minimised without relying on simulated legal transactions. Furthermore, the manner in which the principle of facticity is formulated in the ATPTA makes it difficult to grasp whether it is intended for use in the context of tax avoidance, tax mitigation, or tax evasion.

Both administrative and judicial case law related to the application of the principles of facticity are limited. In 2006, the Supreme Court of Serbia, which was competent in administrative disputes until 2009, applied the principle of facticity to the Tax Administration. The Court found that the Tax Administration wrongfully concluded that the transfer of property from the owner to its company should qualify as a donation merely because the former was completed without any payment.[46] The Supreme Court reminded the Tax Administration that the facts should be assessed in accordance with their 'economic substance'. Another example may be found in the 2014 decision of the Administrative Court, which concluded that when the Tax Administration qualifies one transaction as simulated, it must also indicate which transaction was dissimulated and allow for the party (parties) to actively participate in such proceedings.[47] Finally, the opinions issued by the Ministry of Finance do not contribute to a better understanding of the principles of facticity. Under the ATPTA, implementing acts (e.g. explanations, rulings, instructions, guidance) for bylaws within the competence of the Ministry of Finance, issued by the Minister of Finance, are binding for the Tax Administration.[48] Although the Ministry of Finance typically ends its opinion by referring to this principle, the relationship between the content of an opinion and the reference made to the facticity principle remains unclear. The Serbian legal doctrine considers this reference to be 'abstract'; it is designed to remind the Tax Authority that it alone is responsible for solving an individual tax affair, and that it cannot transfer this responsibility to the Department for Fiscal System within the Ministry of Finance.[49]

Given that Serbia is still not a Member State of the EU, its tax rules do not prescribe the abuse of the law principle *per se*. While waiting for such a principle to be formally introduced into the Serbian tax law system, the legal doctrine recommends that the abuse-of-law principle be used as a tool for interpreting the facticity principle

43 ATPTA, Art. 4–8.
44 See for example: Popović, 2022, pp. 66–70.
45 Kostić, 2016, p. 117.
46 Supreme Court of Serbia, case no. U 120/04, 23 February 2006. As cited by: Popović, 2022, p. 67.
47 Administrative Court, case no. 24 U 3062/12, 7 March 2014. As cited by: Popović, 2022, p. 67.
48 ATPTA, Art. 11 para. 3.
49 Kostić, 2016, p. 122.

laid down by the ATPTA.[50] Indeed, this departs from the position of the CJEU, which understands the prohibition of the abuse of law as a general principle rather than an interpretative tool. However, the Republic of Serbia is not an EU member state that allows such an exercise. Another argument in favour of employing the abuse of the law principle as a tool for interpreting the facticity principle may be found in the fact that both pursue the same objective.

5. Concluding remarks

The national legal doctrine differentiates the three groups of Serbian DTTs according to the manner in which the non-discrimination principle is formulated. The first includes DTTs which do not contain a provision dedicated to prohibiting discrimination. The second group includes DTTs which contain a non-discrimination clause identical or similar to that laid down by the OECD Model Tax Convention. The third group encompasses treaties that prohibit discrimination based on residence rather than nationality. The Serbian legal doctrine explains the residence-based non-discrimination provisions found in several DTTs by the inability to cover persons other than individuals under the term 'nationals'. This approach is typically found in older DTTs concluded in the SFR Yugoslavia and FR Yugoslavia eras.

Serbian tax law does not explicitly recognise the abuse of law principle. Instead, one may rely on the substance over form doctrine, as prescribed under the ATPTA. The Act establishes the principle of facticity as a general principle of tax procedures. Both administrative and judicial case law related to the application of the principles of facticity are limited. References to the principle of facticity can be found frequently in opinions issued by the Ministry of Finance. However, the relationship between the content of an opinion and references made to the facticity principle remains unclear. The Serbian legal doctrine considers this reference to be 'abstract'; the purpose is to remind the Tax Authority that it alone is responsible for solving an individual tax affair, and that it cannot transfer this responsibility to the Department for Fiscal System within the Ministry of Finance.

Tax competition is an important indicator of overall competitiveness. However, this may lead to a 'race to the bottom' between states. Data on the structure of tax revenues show that in Serbia, the tax burden is almost equally split between (personal and corporate) income taxes and consumption taxes, while in Central and Eastern European countries, especially in Western European countries, income taxes account for a much larger share of total tax revenues.[51] In Serbia, there are two main types of incentives from the state that may be awarded for financing greenfield

50 Vasović, 2022, p. 357.
51 Ranđelović, 2022, p. 105.

or brownfield investment projects in the manufacturing sector: (i) investments in material and non-material assets, starting from the submission date of the application for incentive granting until the expiration date of the period for realisation of investment projects, and (ii) gross salaries for newly employed persons over the period of two years after the achievement of full employment with the beneficiary of incentive funds. There are also financial incentives for direct investments in the food manufacturing business, automation of existing capacities and innovations, and the hotel accommodation service sector. Research and development costs related to activities performed in the Republic of Serbia may be double-deducted from corporate income taxes. This incentive does not apply to research costs incurred in extractive industries (e.g. those related to extracting oil, gas, or minerals). Further, the Serbian tax system recognises special tax relief for large investments, as well as payroll tax incentives which cannot be combined with financial incentives.

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