

The Federation of Bosnia and Herzegovina's new laws on contributions and income taxes: in search of optimal rates

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The government of the Federation of Bosnia and Herzegovina recently proposed amendments to a set of laws already in the parliamentary procedure proposing further decreases in social contributions and changes in income tax. The laws are to be implemented from January 2020.



Description

In June 2018 (only a few months before the October 2018 general elections), the government of the Federation of Bosnia and Herzegovina (FBiH) adopted a Law on Contributions and a Law on Income Tax. These laws are still going through the parliamentary procedure.

The proposed Law on Contributions envisages a reduction of total contribution rates from the current 41.5% to 33.5% (pensions and disability insurance to be reduced from 23.5% to 18.5%, health insurance from 16.5% to 13.5%, and unemployment insurance from 2.5% to 1.5%). Unlike the current FBiH entity law that foresees only payroll contributions, it lists all compulsory and voluntary contributions, simplifies calculations, defines the minimum contribution base for different categories of employees, etc. The proposed Law on Income Tax envisages the introduction of progressive taxation: persons earning below KM 800 (€ 410.25) a month would be taxed at 0%, the current rate of 10% would remain for wages of KM 800 monthly, while a 20% rate would apply to those earning above KM 800.

According to government projections, these reforms would have a neutral financial effect on social insurance funds in the FBiH, because the tax base would be broadened to include all fringe benefits (e.g. meal and transport cost allowances). Furthermore, persons working on temporary and freelancing contracts, who are now exempt from paying full social contributions, would have to pay pension insurance of 18.5% and 13.5% for health insurance if not already insured. Based on government

projections of registered salaries and contribution revenues from 2017, taxing of fringe benefits would increase employers' costs for salaries below the average wage if the net wages remain at the same level.

On 26 September 2019, the FBiH government adopted amendments to these laws proposed in June 2018, and forwarded them to the FBiH Parliamentary Assembly. The FBiH government now proposes further reductions in contributions (for pensions and disability insurance, and unemployment insurance) of 0.5 percentage points each – i.e. an overall reduction of one percentage point, down to 32.5% in total. With regard to income tax changes, the FBiH government went back on its earlier proposal to introduce progressive taxation, and instead proposed a single rate of 13%, to be applied to all salaries above KM 800 (€ 410.25). Hence, compared to the current tax model, this would imply an increase of the non-taxable part of salaries from a basic KM 300 (€ 153.80) (which can, depending on the number and type of dependents, be more than KM 800 (€ 410.25), to KM 800 (€ 410.25) monthly without any tax deductions.

It seems that the FBiH government amendments took everyone by surprise except the FBiH Employers' Association, who have claimed for some time that contribution rates of 32.5% and progressive taxation would not reduce the tax burden on labour. During the public hearing procedure in the last quarter of 2017, the FBiH Employers' Association proposed a reduction in contribution rates to 30.5% (pensions and disability to 18%, health insurance

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to 12% and unemployment insurance to 0.5%), and suggested that fringe benefits should not be taxed up to a certain level. The FBiH government rejected this proposal, arguing that it would result in a loss of revenue for FBiH pension and unemployment insurance funds. At the time, the draft Law on Contributions set unemployment insurance contributions at 1% (this was, at the suggestion of the FBiH Public Employment Service (PES), increased to 1.5%). However, in September 2019 the FBiH government changed its mind and proposed to reduce the contribution rate for unemployment insurance to 1%, as in the initial proposal, and to reduce pension insurance down to 18%, in line with the earlier demands of the FBiH Employers' Association. However, the FBiH Employers' Association called on parliamentarians not to support the laws in the absence of a provision stating that any growth in revenues would be matched by a further decrease in contribution rates (N1.info, 26 Sept. 2019).

The new laws and amendments have been criticised by the Trade Unions, which argue that taxing fringe benefits would reduce wages, while the proposed legislation on income tax does not offer any tax deductions. They argue that application of these laws would increase the tax burden on low-income workers, especially in the real sector where a substantial share of workers' wages are paid in fringe benefits (sssbih.com, 17 October 2019).

Outlook and commentary

Under the present legislation, employers have two reasons to provide fringe benefits: firstly, when this is stipulated in collective agreements (this concerns only a

small share of employees); secondly, as a way to top up workers' basic salary while paying fewer taxes. With the implementation of the new legislation, the second reason will disappear. It is difficult to anticipate how many employers will keep the fringe benefits, and whether net salaries below the average wage will be reduced or will remain the same. This will depend on the bargaining power of employers and employees in each individual case and in industry in general. If employers were to keep the employee's costs at the same level, net salaries would be reduced. For this reason, some opposition members in parliament believe that these laws should not be passed without a law on the minimum wage, while the trade unions are demanding a general collective agreement (that would apply to all contracts and all workers).

An increase in the average wage will, *ceteris paribus*, generate an increase in social benefits because the average salary is used as the base for calculating a number of social benefits. Also, taxing of fringe benefits would require changes in pension legislation, because taxing of the transport cost allowance, which is at a different level for every employee, will increase the taxed salary, which is one of the main parameters used for calculating pensions.

The FBiH government assumption that a reduction of social contributions and changes in income tax will result in an increase in employment may prove correct in the long run, but in the short term, substantial government funding will be required to offset the reduction in revenue of the social insurance funds. The FBiH Pensions Fund is due to be transferred to the entity budget by January 2020, which means that the FBiH government

will guarantee pension payments. Cuts in health contribution rates will reduce the revenue of the cantonal health insurance funds, which are already in deficit, especially in more impoverished cantons with less employment (there are ten cantons in FBiH, each of them with its own health insurance and unemployment insurance fund). This would cause even more of a deterioration in health services in these cantons. Moreover, seven cantonal PESs are in constant deficit, struggling with insufficient revenues, which impairs their capacity to implement active labour market measures. Finally, as income tax on salaries makes up around 77% of total income tax revenue, the proposed changes will reduce the income of municipalities with a high number of low-income workers.

Further reading

FBiH Government, Proposal for Law on Contributions, Sarajevo, June 2018.

FBiH Government, Proposal for Law on Income Tax, Sarajevo, June 2018.

FBiH Government, Amendments to the Law on Income Tax, Sarajevo, 26 Sept. 2019

FBiH Government, Amendments to the Law on Contributions, Sarajevo, 26 Sept. 2019

Klix, It industrija na nogama: Ako prođu zakoni Vlade FBiH, stotine miliona KM bit će izgubljeno, 28 Sept. 2019.

N1.info, Poslodavci ne prihvataju izmjene Zakona o doprinosima, traže hitan sastanak, 26 Sept. 2019.

sssbih.com, Intervju/ Šatorović: Vlada FBiH predložila zakone koji će smanjiti ionako niske plate, (17 October 2019).

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