Serbia: Debate on the potential impact of the revised law on personal income tax on the IT sector

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The revisions to the law on personal income tax aim to reduce current evasions of tax payments by imposing new regulations in the area of self-employment. The new regulations are opposed by a number of self-employed IT professionals, since they are the group who will be most affected by the revised law.

Description

On 1 November 2019, the government introduced in the parliament a series of draft amendments to the law on personal income tax. The two main amendments, which will affect almost exclusively the IT sector, are the introduction of two completely new provisions: 1) a "self-reliance/personal dependence test"; and 2) tax subsidies for new employees in innovative businesses in the private sector (for a 36-month period). The "self-reliance test" assesses the business relationship between the self-employed entrepreneurs and their business clients over one calendar year. The test has nine criteria, including: 1) whether at least 70% of the entrepreneur's revenue come from the same business client; 2) whether the work is carried out for at least 130 working days within one year; and 3) whether the work contract prohibits work for others. If five or more criteria are met, the income from the contract will not be taxed as "lump-sum income" at a rate of 10%, but as "other income" at the 20% tax rate.

Founders of innovative businesses are now also exempted from the payment of compulsory social contributions (for a 36-month period), as a result of an additional measure included in a revised law on compulsory social contributions adopted on 6 December 2019. This is expected to facilitate potential transitions from self-employment to employment. The law on personal income tax covers three schemes for taxable monthly income: 1) wages from employment, and payments from temporary and contract work; 2) income of self-employed entrepreneurs; and 3) "other income", i.e. income from capital gains and from work outside the employment relationship. The tax rate for the first two schemes is 10%; it is 20% for the third. Self-employed entrepreneurs, if they do not register as salaried employees, have a choice between two taxable bases: 1) net income; and 2) lump-sum income. The second option is allowed for occupations which do not have to keep financial records, and whose turnover from the previous year did not exceed €51,063 (RSD 6 million). This option is available to those in a wide range of occupations: taxi-drivers, hairdressers, lawyers, physicians, IT professionals, and others. The lump-sum tax base is calculated as the weighted national average wage; the weighting factor combines profitability criteria for every occupation (this base is also used for the compulsory social insurance contributions).

During the last ten years, it has become apparent that some high-paid professions were taking advantage of the lump-sum taxable income scheme, since it allows for much lower tax and social insurance contribution payments. This practice has been observed in the IT sector: employers started to take on self-employed IT professionals registered with the lump-sum scheme, instead of hiring them as regular employees. In 2017, around 46% of IT professionals earned a monthly income of between €1,500 and €2,000 (RSD 175,000-234,000), while the average taxable lump-sum base for this category was around €750 (RSD 87,750) – i.e. they only paid €75 (RSD 8,775) income tax on their monthly earnings.

During the process of drafting the amendments to the law, the lawmakers consulted representatives from the Digital Serbia Initiative, an NGO that was founded by large international and national companies. The draft amendments caused polarisation within the IT community, as owners of small IT companies and self-employed IT professionals were not consulted during the drafting process. In response, they established Digital Community, a grassroots organisation comprising 800 entities, and published an open letter. Their main objections are that the proposed measures create an unpredictable regulatory environment, since a majority of the proposed criteria for the "self-reliance test" are qualitative and subject to different interpretations. In their view, the new measures will lower the competitiveness of small IT companies on the national and international markets, which in turn may induce a further brain drain of IT professionals. They proposed to postpone the adoption of the amendments and to have an open dialogue with all stakeholders in the IT sector.

Outlook and commentary

The purpose of the amendments is to eliminate working relationships which are legally considered as self-employment, but in practice resemble employment; they also aim to facilitate the transition from self-employment to employment in the IT sector. Evidence from those EU Member States which apply similar legal tests in order to classify work relationships shows that tests are inappropriate for analysing work in the platform economy. Difficulties arise due to the complexity of the relationships involved in the provision of work through platforms, since there is no uniform set of contractual arrangements for these jobs.

The lawmakers decided to resolve only one of a number of potential misuses of the lump-sum tax scheme; however, the issue of reduced financial obligations remains. The platform economy is still in its initial phase in Serbia; it is expected that, with the arrival of the new forms of platform work, this issue will have to be regulated again and will also require the modernisation of labour law.

The latest estimates show that in 2017, Serbian companies employed three times fewer IT experts than their competitors abroad, while there is a labour shortage of around 15,000 IT professionals. Sustainable development of the national IT sector is important for the whole economy, so positive business regulation needs to be sustained for a longer period. Consequently, policy makers should find a balance between low-level state assistance to small domestic companies and large state subsidies to foreign companies.

There was no response from the Ministry of Finance to the invitation from the Digital Community for an open dialogue. The law on amendments and additions to the law on personal income tax was adopted by the parliament on 6 December 2019 with minor editing of two criteria for the "self-reliance test".

Further reading

Digital community: official site Digital community, 2019 https://digitalnazajednica.org/

Digital Serbia Initiative: official site Digital Serbia Initiative, 2019 https://www.dsi.rs/en/

European Commission, 2019, Economic Reform Programme of Serbia (2019-2021) - Commission assessment https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/serbia_2019-2021_erp.pdf

European Parliament, Directorate General for Internal policies, 2017, The Social Protection of Workers in the Platform Economy http://www.europarl.europa.eu/RegData/etudes/STUD/2017/614184/IPOL_STU(2017)614184_EN.pdf

Open letter on proposed income tax amendments, on behalf of Digital Community to the Prime Minister and Minister for Finance, 28.10./2019 https://digitalnazajednica.org/2019-10-28-otvoreno-pismo-povodom-zakona-o-dohotku-gradjana.html

Parliament, 2019a, Law on amendments and additions to the law on personal income tax http://bit.ly/30PONXT

Parliament, 2019b, Law on amendments and additions to the law on compulsory social insurance contributions http://www.parlament.gov.rs/akti/doneti-zakoni/doneti-zakoni.1033.html

Vojvodina ICT Cluster, 2019, ICT in Serbia - At a Glance, 2018 https://vojvodinaictcluster.org/wp-content/uploads/2018/05/ICT-in-Serbia-%E2%80%93-At-a-Glance-2018.pdf

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