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Policy brief

ELIMINATION OF TAX AND NON-TAX BURDEN TO START-UPS DURING THE FIRST YEAR OF OPERATION

Young people in Serbia face many difficulties in finding a job, and when they start their own business, the fiscal and para-fiscal levies lower their chances to endure in the market and develop their business. Exemption from salary taxes and contributions during the first year of operations would encourage entrepreneurship in Serbia and eliminate one of the key obstacles to starting and running a business. This measure would result in a reduced number of young people working in shadow economy zone, stimulate the entrepreneurial spirit and economic engagement of youth, without the effect of market distortion and realistic burden to the national budget of the Republic of Serbia.

SITUATION ANALYSIS

According to the National Statistics Office, in the last quarter of 2016 the unemployment rate among young people aged 15-24 was 31.3% which is nearly three times higher than the overall unemployment rate in Serbia of 13%. The percent is also twice as high compared to the European average – according to the Eurostat data of February 2017, the unemployment rate was 18.5%. However, even though it is difficult for young people to find a job, self-employment as a form of work activity is very rare among this category in Serbia – only 7.8% have a status of an employer or running a family business.

As shown by the research conducted by the Economic Institute in 2016 based on focus groups with 55 young entrepreneurs from Serbia, the key issues they see as obstacles to starting a business include the underdeveloped entrepreneurial culture and non-stimulating business environment, the lack of necessary entrepreneurial knowledge and mentor support, and high tax burden. Bearing in mind that the burden of fiscal and para-fiscal charges represents a major problem for beginners in business ventures, particularly the income tax and contributions for mandatory social insurance, the proposal is to introduce exemption from these levies during the first year of work, which would enable new entrepreneurs to pay their liabilities to the state only upon developing their business to a certain extent¹. This measure is specifically aimed at encouraging entrepreneurship among youth – those who graduated from faculties or complete high school, though the right to use this measure would be provided to all persons who had previously been registered in the National Employment Office records for more than six months.

THE COSTS OF STARTING A BUSINESS

With the support of German Development Cooperation, NALED prepared a policy brief on introducing exemption from salary taxes and contributions during the first year of work, based on the analysis conducted in cooperation with the Faculty of Political Sciences from April to June 2017. Practicing simulation and using appropriate assumptions and information regarding the “price” of starting a

¹ This proposal was adopted by the Coordination body of the Government of Serbia for managing activities aimed at countering shadow economy, within the Action plan for 2017 and 2018 (measure 2.1.4)

business, it was determined that the costs of registering as an entrepreneur go from RSD 4,610 up to 31,610, while the price for establishing a limited liability company ranges from RSD 10,370 to 57,370.

Table 1: Costs of starting a company or registering as entrepreneur in Serbia (RSD)

No	Expenses	Entrepreneur	Company
1	Fee for registering a business	1,500	4,900
2	Creating the founding act and Statute (optional)	/	20,000
3	Registration and publication of the founding act	/	1,000
4	Reservation of business name (optional)	1,000	1,000
5	Verification of the founding act	/	1,260
6	Verification of signatures form	360	360
7	Creating a stamp (average)	2,000	2,000
8	Opening a bank account	0	0
9	Basic financial capital	/	100
10	Account maintenance (monthly)	450	450
11	E-banking (monthly)	300	300
12	Bookkeeping services (optional – monthly)	6,000	6,000
13	Registration in Tax Administration	0	0
14	Fiscal cash register (optional)	20,000	20,000
Total min (excluding optional costs)		4,610	10,370
Total max (including optional costs)		31.610	57.370

As for the monthly expenses for taxes and contributions, the analysis showed that an entrepreneur needs to pay from RSD 12,245 to 32,892, while a limited liability company would need to allocate RSD 14,813.48 a month for this purpose.

Table 2: Overview of monthly and annual taxes and contributions for newly established entities

Type	Monthly taxes and contributions	Annual taxes and contributions
Entrepreneur – lump sum taxation	12,245 - 32,892	146,940 – 394,704
Entrepreneur – personal salary regime	19,820	237,848
Entrepreneur – self-taxation regime	12,893	154,717
Company	14,813	177,761

This means that, even when they are not gaining any revenues, new businesses need to pay an amount ranging from RSD 151,550 to 426,314 (entrepreneurs) or from RSD 188,126 to 235,126 (companies), for the costs of starting a business along with taxes and contributions. The calculation shows that the costs of starting a business in Serbia significantly vary, depending on the legal form, the local government where a business is registered and other optional costs taken into consideration.

REFORM RATIONALE

Measure: Exemption from corporate income tax and salary taxes and contributions, or the determined lump sum tax, during a period of one year.

Beneficiaries: Persons who had the status of graduate students or completed high school (in Serbia or abroad) in the previous six months, or persons who had been registered in National Employment Service records in the previous six months.

Limitations: Exemption from taxes and contributions for a period of one year could only be used once, with beneficiaries being micro businesses only. If a person fulfills all the stated criteria and establishes multiple businesses, the tax exemption measure can be used for only one business. Furthermore, the measure would refer to all new employees in startups who fulfill the defined conditions, and given that the measure refers to micro businesses, the maximum number of newly employed persons is 9. Bearing in mind that the value added tax (VAT) as a consumption tax represents a separate taxation item in the tax system, the obligation of paying VAT remains in line with the Law on Value Added Tax.

Beneficiaries' rights and obligations: In line with Article 8 Paragraph 1 Item 15a) of the Law on contributions for mandatory social insurance, the beneficiaries would be included in the group of insured persons for whom health insurance contributions are covered from the state budget. Given that they would be exempted from paying contributions for pension and unemployment insurance, they would not be entitled to use these rights. However, they would have an opportunity to pay the pension insurance themselves, and thus be entitled to pension benefits. The beneficiaries would be entitled to use other incentive measures simultaneously, with a limitation in line with the Regulation on the rules for awarding state aid, stipulating that the total amount of all forms of state aid does not exceed RSD 23,000,000 in any period within three consecutive fiscal years.

The state's opportunity cost: The tables below provide a calculation of the number of potential beneficiaries and the overview of opportunity costs of the measure, based on the data received from the National Statistics Office and National Employment Service, the records of ENIC/NARIC center² of the Ministry of Education, Science and Technological Development, and in line with the results of the survey *Transition of young women and men in the labor market of the Republic of Serbia*³.

Table 3: Number of beneficiaries of the measure enabling exemption from taxes and contributions

	Number of students who completed their studies in 2015	Number of high school students who did not enroll at faculties in 2015	Number of student returnees – migrants in 2016	Number of unemployed persons in 2016 who used incentives for starting a business > age 25
Total	50.326	6.313	1.145	3.273
Share ⁴	7,8%	7,8%	7,8%	100%
Total	3.925	492	89	3.273
Expected number of beneficiaries	7.779 (1.556 companies and 6.223 entrepreneurs) ⁵			

² Information center for recognition of international faculty and high school documents, for employment purposes

³ Marjanović D. (2016), *Transition of Young Women and Men in the Labor Market in the Republic of Serbia*, International Labor Organizations, page 15

⁴ Starting from the assumption that 7.8% of youth will start their own business, and that the measure will be used by the same number of unemployed persons older than 25, who have used the incentives for starting a business so far.

⁵ 20% of all newly registered businesses are companies, while 80% are entrepreneurs

Table 4: Opportunity cost for the exemption of taxes and contributions during the first year (RSD)

Type of business	Number	Monthly expenses for taxes and contributions per business	Monthly opportunity cost	Monthly opportunity cost - total (min-max)	Annual opportunity cost - total (min-max)
Company	1.556	14.813	23.049.028	116.306.906 - 159.139.815	1.395.682.872 - 1.909.677.780
Entrepreneur	6.223	14.986 – 21.869	93.257.878 – 136.090.787		

According to the calculation, **the expected number of beneficiaries is 7,779, while the estimated costs range from RSD 1.4 billion to 1.9 billion for a year**, which is eight times lower than the amount allocated by the state during the Year of Entrepreneurship for the needs of stimulating entrepreneurship activities.

Global experiences: Some examples of countries that recognized the tax and non-tax burden as an obstacle to startup development and introduced tax exemption measures for new businesses include Albania, India, Ireland, China, Latvia and Singapore. The most common model used to apply such measure stipulates that within a determined time period (three to five years), startups whose annual turnover does not exceed a certain amount (from EUR 36,000 to EUR 93,000) are exempted most commonly from taxes only (capital gains tax, corporate income tax, individual income tax, startup investments tax), while some countries also practice exemptions from social contributions. The effects of this measure have been an increased number of startup companies and a higher share of foreign direct investments in these countries. Though tax measures targeting new businesses are different in each stated country, one thing they have in common is the tendency to ease the beginning of business operations by reducing the tax and non-tax burden.

Effects: The measure would ease the beginning of work for new businesses, as it is hard to expect someone who has just recently started working, without gaining income in the initial phase, to start paying obligations to the state as soon as they are registered. It is assumed that the exemption would stimulate young people to dare and start their own business, encourage them to opt for legal operations from the very beginning, make small businesses more competitive and lead to a reduction in youth unemployment.

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For more information see:
Analysis of Tax and Non-Tax Burden to Start-Ups, Belgrade 2017