

Serbia Introduces Special Tax on Extra Incomes and Extra Property

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Introduction

During the years of autocratic rule of Mr. Milosevic corruption was one of the main pillars of the regime. Rule of law was suspended and tax legislation was not applied equally to all taxpayers. Isolation of the country from the international community and subsequent trade embargos imposed on Serbia, non-transparent public procurement as well as largest hyperinflation in Europe ever recorded, which occurred in late 1993, were all seen as fortunate circumstance for a rather small circle (estimated number of around 200 families) around Mr. Milosevic and his ruling elite, to illegally accumulate wealth using their privileged position.

The new Government of Serbia, led by Dr Zoran Djindjic, which has been elected in late December 2000 following the initial democratic changes of October 5th, 2000, took the fiscal reform, fight against corruption and privatization process, as it's primary goals.

With this goals in mind, underlying the principles of rule of law and fiscal justice, the Parliament of Serbia has adopted on June 22, 2001: "***Law on one – time taxation of extra income and extra property acquired by using the special privileges***".

It has been emphasized, in this legal act, that it is going to be used as non regular, non recurrent i.e. one a time form of the revenue of the budget of Republic of Serbia, for the fiscal year 2001.

Even, there have been certain concerns that newly enriched individuals and companies which made their fortunes during the Milosevic reign will try to take their capital out of the country. In addition, despite the eventual problems with which the Internal Revenue Service of Serbia will be faced when assessing the due tax in individual cases, the Government took a courageous stand and took the Bill to the Parliament, where it was subsequently adopted.

What is being taxed?

The tax is aiming at extra income and extra property acquired from January 1st 1989 up to June 23, 2001 (day of the entrance of the Law in force), which has been generated by usage of special privileges defined by the Law.

Taxpayer

The taxpayers are those legal and physical persons, which had access to the special privileges during the time span specified by the Law.

The Law has built in provisions extending the tax liability to persons to whom the taxpayer has transferred, in the form of the gift the rights (parts of the property), acquired through the transactions, which imply the tax liability.

In the same time, the Law extends the liabilities of the legal persons, which qualify as the taxpayers, in the cases where they ceased to exist, under the bankruptcy proceedings, to the natural and legal persons who were their respective founding members.

Transactions implying tax liability and taxable basis

The Law is specifying transactions, which fall under the concept of special privileges accessible to particular persons. Some of these transactions are rather peculiar and occurred under the circumstances of closed economy, suspended rule of law and highly non - transparent public finances. As such and being described in the new Serbian Law, they create a quite unique case in the post II World War tax history of the Europe.

These include:

- 1) Receiving loans from the funds created by the primary and gray (illegal) issuance of the money by the Central bank and other financial institutions, in the financial transactions on the open market. During the rule of Mr. Milosevic, Central bank was directing the privileged loans to the state owned companies, run by his loyalists, who were speculating with domestic currency (Yugoslav dinar), under the circumstances of rising hyperinflation, being able to generate huge profits through purely financial transactions. In this case, taxable base is defined as the left over amount of the loan, received from the primary source and the real value of the loan paid back to the Central bank.
- 2) Purchasing of the hard currency from the Central bank at the time when the real, market exchange rate was higher. This was one of the favorite mechanisms for theft of public funds exercised by Mr. Milosevic regime. Only those importing companies, which were close to the regime, were privileged to acquire hard currency for the Yugoslav dinars, at the official, fixed exchange rate, when at the same time, the market exchange rate was fluctuating and was higher than the official one, which was the common type of situation (as the hard currency was scarce). For this type of transaction, taxable base is defined as the difference between dinar value of the hard currency under the market exchange rate and the

dinar value of the hard currency acquired, under the official exchange rate, on the day when it was purchased from the respective bank.

- 3) Export of the hard currency based on the advance payments of the goods to be imported, which subsequently never happened, or usage of the services for which an invoice has been received by Yugoslav firm, but the services have never been provided. For this type of transaction, taxable base is defined as the value of advance payment for imports, which have never occurred, i.e. value of invoiced and never received services;
- 4) Import and distribution of goods which fall under the taxation by excise duty, without the payment of customs, other import and excise duties, sales tax, as well as other fiscal charges targeting consumption; During the former regime and especially in the times of UN and EU embargos on trade, special groups of individuals and companies were allowed to import highly taxable goods, such as tobacco products without paying charges on these transactions. This was highly lucrative business of smuggling goods with the blessing of the ruling party. Besides taxation, the new government took a number of other measures to put an end to these practices. For this type of transaction, taxable base is defined as the value of unpaid fiscal charges capitalized at the interest rate equal to the discount rate of the Central bank of Yugoslavia, increased for 30%, by using the conform accounting method;
- 5) Export and import of the goods, under the foreign trade regime of quotas and permissions, implemented by using the special privileges for obtaining these import entitlements; This was one of the favorites among the system of privileges created for the loyalists of the former regime. Through the system of quotas foreign trade with many of the products was highly controlled and only firms with "good connections" were able to do business. For this type of transaction taxable base is defined as the value of import or export, according to the provisions of the Customs Act.
- 6) Usage of the funds of the legal person for which the assessed public duties have not been paid, such as the usage of the undeclared revenues in cash; For this type of transaction, taxable base is defined as the value of the undeclared cash funds obtained from the customers, upon the deduction of the costs related to the creation of the respective revenue;
- 7) Procurement deliveries and purchases of goods from the State Commodity Reserve (SCR) under the privileged conditions (without a public auction, i.e. under the direct deals concluded); This kind of operation was particular source of corruption during the Mr. Milosevic rule. It was based on the lack of transparency and competitive public bidding in transactions undertaken by the government controlled SCR. For this type of transaction, taxable base is defined as the difference between the price under which the SCR has acquired the goods from the tax payer and market value of these goods, i.e. difference between the market

- price under which the SCR goods could be sold and the one which was used for the actual transaction with the tax payer;
- 8) Disposal with the resources of: state budget, state social security funds, state owned enterprises and institutions in a manner not in conformity with the provisions of the Laws, i.e. in a way which does not serve their predetermined purposes; The use of public funds, even though regulated rather strictly, was not followed by the former regime, which used much of the public funds for different sorts of projects in line with its peculiar priorities. For this type of transactions, taxable base is defined as the net income expressed in money, movable property and the real estate, which has been acquired by the illegal exploitation of the public funds described.
 - 9) Disposal with the public funds (described under point 8.), by creating bank deposits under the lower interest rate, than the one, which could be achieved at the given moment at the market, with subsequent usage of the deposited funds under the higher interest rate; This type of transaction reflects mismanagement of the public funds for the private benefit and is an additional example of the corrupt behavior of the former regime. For this type of transaction, taxable base is defined as the difference between the interest rates under which the public funds have been really deposited and the one under which they have been officially placed under the deposit.
 - 10) Unlawful use of the public funds generated through different public schemes aimed at the relief of the damages caused by the earthquakes in certain regions of the country, where a taxable base is defined as the respective amounts increased for the accrued interests;
 - 11) Abuses in the privatization procedures of the socially owned enterprises by directors (general managers) or other members of managing boards, or members of their families; As privatization process has been canceled two times before the latest Privatization Act has been enacted, there were cases, where it has not been clear whether the all rules were followed, including those of previously issued due diligence (valuation) reports. For this type of transactions taxable base is defined as the nominal value of the stocks acquired through the privatization and in the case of them being sold further, market value of such stocks;
 - 12) Acquiring ownership over the state owned apartment bigger than 90 sq. meters, by the elected or appointed state official, officer of the political party, general manager or the member of the Board of the legal person owned by the state or socially owned, except in the cases where the regulations allowed such possibility; For this type of transaction, taxable base is defined as the surface of the apartment/real estate higher than the one prescribed by the applicable regulations;

- 13) Usage of the loans for the purchase of the apartment described under the point 12. For this type of transaction taxable base is defined as the surface of the apartment/real estate higher than the one prescribed by the applicable regulations;
- 14) Construction of the representative residential or business facility (i.e. value of more than 500.000 DEM) with a surface larger than the one allowed by the applicable construction regulations. In this situation, we find description of the case where privileged persons were able, irrespective of the Law, to build large size facilities such as villas and office buildings. For this type of transaction taxable base is defined as market value of the surplus surface of the constructed facility above the one, allowed by the regulations;
- 15) Usage of the loans for acquiring the business facilities or other real estate and equipment, under the conditions more favorable than those on the open market; In this type of situation the legislators are targeting beneficiaries of the privileged loans allowed by the state controlled banks in the previous 12 years. For this type of transaction, taxable base is defined as the amount of the loan increased for the accrued interests, upon the deduction of the due amounts paid back, including the annuities and interests.
- 16) Doing business with the public funds or funds owned by state or socially owned enterprises, or their usage by the legal or natural person in the ways of transferring them abroad at the account of that person or at the account owned by other related person. In this case, in partly not so well designed legal norm the legislators are targeting the situations in which the state funds were used by private persons close to the regime, by transferring them abroad at the private accounts, which was particularly the case with certain off shore jurisdictions in Europe. For this type of transaction taxable base is defined as hard currency amount transferred, increased for the accrued interests equal to the LIBOR + 2% using the conform method;
- 17) Using the funds deposited by the citizens at the banks organized as the pyramid schemes, as the loans; When describing this case, we need to explain that the former regime has caused hyper inflation by printing money, in order to offset soaring public revenues related to the support to the Armies of Bosnian and Croatian Serbs, especially in the period 1992/93. This was followed by support to at least two wide scale operating "wild cat banks" (these were: "Yugoscandic bank" and "Dafiment bank") established on the principles of pyramid schemes. These banks were paying high interest rates for the hard currency deposits, attracted from the citizens. When they collapsed, more than one billion DEM in debts was left over. Both operations were indirectly controlled by the regime and individuals close to the regime, in the form of different kinds of soft loans. For this type of transaction taxable base is defined as hard currency amounts taken as the loan, increased for the accrued interests equal to the LIBOR + 2% using the conform method;

- 18) Privileged payments of the frozen hard currency deposits as well as the saving deposits in the pyramid scheme banks in the amounts greater than 10.000 DEM per saving deposit. When the old Yugoslav federation collapsed in 1991 government was not able to back up the hard currency deposits of the citizens in state owned banks and declared it "frozen" creating a large public debt. However, in certain number of cases, privileged persons were able to get their deposits back, often through corrupted channels in the banks. They are targeted under the described transaction, as well as those who got their money back from the pyramid scheme banks, which was not possible without influential links with the regime. For this type of transaction taxable base is defined as the value of the payment actually made by the bank.
- 19) Using the funds under the: "*Loan for the Economic Revival of Serbia*". This loan was introduced in 1990/91 through the bonds issued by the Milosevic government. As the bonds became mature it was not possible for their holders to receive back the funds they have invested, including the accrued interests, except for those privileged few which are actually been targeted under the provisions of the Law. Funds accumulated through the bond issuance were channeled as loans under very favorable terms to the selected number of enterprises, mostly those preferred by the regime. For this type of transaction, taxable base is defined as the difference between the real value of the loan received under the scheme and the real value of the funds paid back.
- 20) Purchase of the arable land or of the land determined for construction, which has been state or socially owned by the elected or appointed person, including those from the local governments. This includes the cases when the land was acquired by the family members of described officials, as well, if the transaction was closed through the bid with only one competitor. For this type of transaction, taxable base is defined as the difference between the amount paid and real market value of the land.

It is important to note that the tax basis for all of the described transactions is expressed in DEM, which facilitates the process of the assessing the tax, bearing in mind high and fluctuating levels of inflation present in Serbia during the nineties.

Tax rates

Tax rates of the special tax are steeply progressive as presented under the Art. 10 of the Law:

APPLICABLE AT THE TAX BASE	TO BE PAID
up to 100.000 DEM	30 %
from 100.000 up to 200.000 DEM	30.000 DEM + 33% at the amount exceeding 100.000 DEM
from 200.000 DEM up to 400.000 DEM	63.000 DEM + 36% at the amount

	exceeding 200.000 DEM
from 400.000 DEM up to 600.000 DEM	135.000 DEM + 39% at the amount exceeding 400.000 DEM
from 600.000 DEM up to 800.000 DEM	213.000 DEM + 42% at the amount exceeding 600.000 DEM
from 800.000 DEM up to 1.000.000 DEM	297.000 DEM + 45% at the amount exceeding 800.000 DEM
from 1.000.000 DEM up to 1.200.000 DEM	387.000 DEM + 48% at the amount exceeding 1.000.000 DEM
from 1.200.000 DEM up to 1.400.000 DEM	483.000 DEM + 51% at the amount exceeding 1.200.000 DEM
from 1.400.000 DEM up to 1.600.000 DEM	585.000 DEM + 54% at the amount exceeding 1.400.000 DEM
from 1.600.000 DEM up to 1.800.000 DEM	693.000 DEM + 57% at the amount exceeding 1.600.000 DEM
from 1.800.000 DEM up to 2.000.000 DEM	807.000 DEM + 60% at the amount exceeding 1.800.000 DEM
from 2.000.000 DEM up to 3.000.000 DEM	927.000 DEM + 63% at the amount exceeding 2.000.000 DEM
from 3.000.000 DEM up to 4.000.000 DEM	1.557.000 DEM + 66% at the amount exceeding 3.000.000 DEM
from 4.000.000 DEM up to 5.000.000 DEM	2.217.000 DEM + 69% at the amount exceeding 4.000.000 DEM
from 5.000.000 DEM up to 6.000.000 DEM	2.907.000 DEM + 72% at the amount exceeding 5.000.000 DEM
from 6.000.000 DEM up to 7.000.000 DEM	3.627.000 DEM + 75% at the amount exceeding 6.000.000 DEM
from 7.000.000 DEM up to 8.000.000 DEM	4.377.000 DEM + 78% at the amount exceeding 7.000.000 DEM
from 8.000.000 DEM up to 9.000.000 DEM	5.157.000 DEM + 81% at the amount exceeding 8.000.000 DEM
from 9.000.000 DEM up to 10.000.000 DEM	5.967.000 DEM + 87% at the amount exceeding 9.000.000 DEM
more than 10.000.000 DEM	6.817.000 DEM + 90 % at the amount exceeding 10.000.000 DEM

Reporting of the eligible persons

Persons eligible to pay this tax have to report to the tax authorities in the period of 30 days after it's entrance into force, i.e. by July 23, 2001. Those who do not report in the term specified will fall under the penal provisions of the Law.

The tax assessment can be initiated, as well, before the Internal revenue Service of Serbia *ex officio*, by the Anti Corruption Commission, in the cases identified during it's proceedings and investigations.

Internal Revenue Service of Serbia is obliged to submit monthly reports to the Parliament of Serbia about the progress on the proceedings initiated in the tax collection under this Law.

Concluding remarks

By passing the "*Law on one – time taxation of extra income and extra property acquired by using the special privileges*" new Government of Serbia **has identified sources of wealth creation through the corrupt behavior, which was pursued by the members and allies of the former regime.**

By this legal act the government intends to tax persons (individuals and companies) which were in the privileged position during the rule of Mr. Milosevic. This will not pardon them from other eventual legal liabilities (Criminal Code).

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