**University of Economics in Prague**

**Faculty of Finance and Accounting**

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# Tax System of the Czech Republic and the Republic of Serbia:

Comparison of the Two Systems in Terms of Serbia's Tax System Harmonization with the European Union

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# Topic:

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Comparison of the Two Systems in Terms of Serbia's Tax System Harmonization with the European Union

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## Declaration:

I hereby declare that I wrote this master thesis "Tax System of the Czech Republic and the Republic of Serbia" by myself. All used literature and background materials are stated in the attached list of sources.

In Prague, December 2014 ………………………

Student's signature

## Acknowledgement:

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## Abstract:

This mater thesis focuses on the comparison of current tax system of the Czech Republic and the Republic of Serbia. In theoretical part of the thesis, individual taxes in both countries are characterized and defined. Additionally, in the analytical part of the thesis, tax systems are compared using selected indicators. Comparison of the two tax system is made in terms of Serbia's tax system harmonization as one of the country candidates for the EU accession.



*Keywords*: Czech Republic, Republic of Serbia, taxes, tax system, analysis, indirect taxes, direct taxes, comparison, EU country, non-EU country

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# Introduction

Tax had a different form in the past than it does today. Nonetheless, it is as old as a state is. The state, whether it was represented by whomever, always felt an obligation to pay for certain needs, such as country's defense, war campaigns promising not only conquest of new territories but also rich incomes and wealth, or the services provided by the emperor or the person in charge. Soon afterwards the state also felt the need to create certain reserves for the so called "rainy" days.

It was impossible to meet such needs without defining who, what, when and in what amount it is necessary to contribute to the state's common fund. Power of the state started to bind individuals towards the takeover of a defined share in order to cover the state's common needs. As a result, state started to enforce taxes, no matter the price. Even today, taxation system is a very important tool of every state, and it largely affects not only state's economy, but also its competitiveness in the terms of development and investment of legal entities, all entrepreneurial as well as non-entrepreneurial subjects, and the life of each individual living in the particular state.

Taxes strongly effect the redistribution of national income, through the management of economic and social policies. Taxes became a significantly powerful tool affecting the processes of production, distribution, consumption, investment, demographic factors, export and import, as well as a number of other economic factors. Taxes, as instruments of fiscal policy, became one of the main instruments of stabilization policies.

Every state's main task is to ensure sufficient funds to the state's budget. Its setting, predictability in time, clarity, simplicity, stability or on the other hand complexity, plays a very important role in the state's development as well as its well-being, and it also creates certain competitiveness with other countries. Tax systems are constantly evolving, adapting and changing throughout the time in regards to the needs and conditions of individual countries. It also reflects legal requirements and standards of the European Union (EU), which created more or less a unified form of an "ideal" taxation system, which all EU countries try to follow; EU country candidates try to follow patterns leading to harmonization with EU as well. Throughout my master thesis, I will focus on the tax system of the Republic of Serbia, as a currently non-EU country, nonetheless an EU member candidate, and the Czech Republic as an EU member country.

The goal of my master thesis is to introduce and present the tax systems of the previously mentioned countries, and to make a comparison between their taxation systems in order to identify similarities and differences.

The first part of my master thesis is going to be theoretical, where I will introduce basic general concepts concerning taxation. In this part, I will also describe tax systems of the Republic of Serbia and the Czech Republic. The second part of my thesis is going to be practical; in this part I will make a comparison of the corporate income taxes (CIT), personal income taxes (PIT), property taxes, excise taxes, value added tax (VAT), tax mixes, tax quota as well as tax reliefs in order to present in which terms is Serbia's tax system similar to the tax system of the Czech Republic, and in which terms it is different. I will primarily use analytical and synthetic methods throughout my research, as well as description and comparison methods, with the use of graphs and tables in order to reach a clearer and more precise visualization of the collected data.

# I. Theoretical Part

## 1 Tax System

Tax system is probably one of the broadest terms used in the theory and practice of taxation. Its minimum dimension is taxation structure used on a given territory and tax administration, or the part of public administration that ensures the selection of certain tax types. In addition to this, we can also include many other dimensions of the tax system, in accordance to which perspective the topic is being approached to. Medveď in his book "Daňová teória a daňový systém" asserts that Professor Joseph Stiglitz, for example, defined that the basic requirements of a tax system should be economic efficiency, administrative simplicity, flexibility, clear relationship with the political systems, and justice; therefore in this case it is clear that the tax system was perceived as a broader topic (Medveď, 14).

According to Stiglitz, state governance is one of the most important public goods. We all benefit from a better, more effective and more responsible state. From the benefits that the state provides, it is difficult and undesirable to exclude any individual. If the government is capable of being more efficient by not reducing the scope of services and to reduce taxes, everyone benefits. State management can be viewed from different angles. However, one of the most important aspects of governance is in fact the management of the states' public goods or services and, most importantly, of the funds and the budget of the country (Stakić, Jezdimirović, 78).

Modern tax systems of different countries differ. The differences between them are primarily determined by their economic and political organization. The place and role of certain taxation forms in industrialized countries differ from those in countries which are in the transition phase. Additionally, there are differences in the tax systems of unitary states, in comparison to the tax systems of federal states. Although the differences between the tax systems can be attributed to many factors, the most important amongst them are differences in the development of economies, educational levels of the population, structure of the labor force, character of the state system, membership of a particular international organization and methods of financing of general and common needs.

## 1.1 Basic Taxation Terminology

In this part of my master thesis I will mention the terminology connected to taxation, which is important for us in order to properly understand the whole material and its content and which will accompany us throughout the entire research.

Although we come across certain activities connected to taxation in our everyday lives, whether it is tax payment, tax calculation or tax return, we still are sometimes not able to accurately classify these terms and concepts, or we are not completely certain of what these terms and concepts entail and what their full content is. For this particular reason, before I start to analyze the tax systems of the Czech Republic and the Republic of Serbia, I would like to briefly describe the basic taxation terminology. I will start by explaining what is the meaning of tax itself, since that is one the most important concepts for understanding taxation systems of the both countries, and taxation in general, as well as due to the fact that this concept will be constantly present throughout my entire diploma thesis.

### 1.1.1 Tax

The word tax has most probably been derived from an old word meaning ‘to touch’ (Frend, 31), and is a word used to express a certain charge made to the subject by the state. This charge is made in return for commodities, personal services, or money. Since money is the great standard of worth in modern times, the charge of tax is now generally limited to money, and it is payable by the subject in various ways. The process of taxation is the act of setting taxes or making charges. The principles by which the state is guided in setting the taxes are the principles of taxation. Three things need to be considered in taxation: the subject, the state, and the things taxed or charged. By raising money from the subject, the state proposes a certain good to particular members or the whole community. The subject to taxation gives up a certain good, either through fear of a certain evil, or in hopes of some personal good. Subject of taxation may be everything or anything which is useful, convenient, or necessary for the subject (Frend, 31-32).

Now that we are aware of that taxes are, in the upcoming paragraph I will elaborate on what are the actual objectives of taxation, since it is crucial for us to know where our taxes actually go to, and what is the purpose of the whole taxation process.

### 1.1.2 The Objectives of Taxation

The rationale for imposing taxes in a market economy branches from the following government responsibilities:

***1)*** *To provide public goods*

A pure public good is a good which shows the following characteristics:

- Displays zero marginal cost, which means that there are no extra costs incurred in supplying a good to more than one person,
- Even if they have no desire for it, individuals cannot be excluded from consuming the good,
- All members of society must consume the safe amount, and it cannot be rejected (law and order for instance).

***2)*** *Redistribution of wealth and income*

Thanks to redistribution of wealth and income there is a Promotion of social equality by the use of benefits and transfer payments for the purpose of helping members of society who are less well-off.

***3)*** *To promote social and economic welfare*

Governments often take on a paternalistic role by providing ‘merit’ goods, such as education and health. Unlike public goods, merit goods can be provided privately, but if left completely to market forces, these goods would be under-consumed; therefore there is some merit in the state providing such goods as everyone benefits from living in a more educated and healthy society, meaning there are external benefits in the provision of merit goods. For the same reasons demerit goods, such as cigarettes and alcohol, are discouraged by governments in order to reduce the external costs to society, such as health risks and pollution.

***4)*** *Economic stability*

The government is responsible for avoiding high levels of unemployment and inflation in order to promote sustainable growth and economic stability.

***5)*** *The single European market*

In January 1993 the single market has been introduced, which is making more pressure on governments to be in harmony with other EU member states.

***6)*** *Regulation*

In order to protect employees, consumers and the general public, regulatory and legislation controls are made on producers, which in fact is the responsibility of any socially aware government. Taxation, taken into consideration its general responsibilities, can be a powerful tool in the hands of any government as a means of ensuring political, social, and economic policies of the government in power.

### 1.1.3 The Taxpayer

This paragraph is important for each and every single one of us, since we ourselves are taxpayers, and whether we like it or not, we have a certain obligation towards the state that we live in. The characteristics of any state's history has also always been about who was obliged to pay taxes. Back in the day, the feudal nobility and the church did not have to pay taxes, however today modern tax system is characterized by tax obligations by default (Vančurová, Láchová, 2010, 13).

A taxpayer is a person who by law is obliged to pay taxes. By default, a taxpayer is obliged to pay taxes on his or her own initiative. The individual's income or property is subjected to taxation. The taxpayer is the intended bearer of the tax burden. The tax bearer should be the same person whose available sources are reduced by tax collection. However, sometimes what is meant to be done is not necessarily always enforced. For example, a property tax payer may be able to include his or her property tax in the rent price; therefore tenant would be the tax bearer. Determining the taxpayer in certain cases would be administratively burdensome and it has been shown to be even useless at times. Thus, we meet with other types of taxpayers (Vančurová, Láchová, 2010, 14).

### 1.1.4 The Tax Base

By the taxation subject we generally mean the value of which the tax is levied from. Its concise definition is usually a part of a taxation law, such as income tax law or real estate taxation law. According to who the object of taxation is, we divide taxes into four major groups: *Poll Tax, Property Tax, Income Tax and Consumption Tax.*

Poll tax is the oldest type of tax, where a person is the subject to taxation; it is also called the 'head' tax. On one hand, from a theoretical point of view, such a tax has a number of advantages (for example in case it is a general tax, it cannot be escaped), on the other hand in the current tax systems it is rarely used. Additionally, there are huge disadvantages of this type of tax, because of its impact on some taxpayers can be unbearable. The poll tax is sometimes also called a flat tax. Such a tax can easily be set if we calculate the expenses which we wish to fund from the tax revenue, and we divide it by the number of taxpayers (people). The disadvantage of this kind of tax occurs when it comes to babies for instance.

Another tax type is property tax, which also has a very long history. Property is generally visible and it does not require any evidence. Real estate in particular is a very popular taxation subject, because of its basic characteristics, which is that it is impossible to move, it is visible, and thus it is difficult to conceal. Property taxes are usually levied through the taxpayer (Vančurová, Láchová, 2010, 16). Furthermore, income taxes as well as consumption taxes are going to be analyzed in the second theoretical part of my diploma thesis.

### 1.1.5 Tax Rate

Tax rate is the percentage at which a corporation or an individual is being taxed at. It is the tax imposed by some states and the federal government based on the corporation's earnings or a certain individual's taxable income. A tax rate is the percentage of a corporation's earning or an individual's taxable income that is owed to federal, or in some cases municipal governments and the state (Tax Rates, Investopedia).

### 1.1.6 Tax Revenues

Naturally, governments create particular revenue out of tax money. Total tax revenue is the income which government generates through the taxation of its citizens. It includes taxes on imports and production, capital gains, current tax on wealth and income, as well as social contributions. Total tax revenue is an aggregate which consists of:

- Taxes on imports and production, such as value added tax (VAT), payroll taxes, duties and consumption taxes, stamp taxes, taxes on pollution, and others;
- Current taxes on income and wealth, such as personal and corporate income taxes, current taxes on capital that are paid periodically, taxes on holding gains, payments by households for licenses to own or use cars, hunt or fish, and others;
- Capital taxes, such as inheritance taxes, taxes on gifts and capital levies that are exceptional or occasional;
- Actual social contributions paid on a voluntary or compulsory basis by employees or employers, the non or self-employed to insure against social risks (old age, invalidity, sickness, disability);
- Implicit social contributions payable under unfunded social insurance schemes (where social benefits are being paid by employers to their ex-employees, current employees, or their dependents out of their own resources) (Glossary: Tax Revenue).

## 1.2 Tax System Requirements

There is no such thing as an ideal taxation system, since an ideal taxation system, at least for the subjects of taxation therefore taxpayers, would be a system without taxes, which in fact does not exist. Each country imposes taxes in its own way. However, there are certain requirements which are necessary for a good tax system. These requirements are:

- *Tax fairness*: through taxes, each subject contributes to the public budget; these contributions should on one hand match the subject’s possibilities, and on another hand the benefits that the subject gets from services provided by the state;

- *Tax efficiency*: market relations should be the ones least affected by taxes, and therefore, taxes should not cause any kind of distortion between the public revenue and the loss of the subjects' benefits;
- *Legal accuracy*: this is an essential requirement for a good tax system, since through legal accuracy can a tax system be fully efficient, and only then government is able to collect taxes effectively and ensure other functions; imprecise taxation law formulations cause the possibility of tax avoidance, which most certainly always disrupts the tax system parameters;
- *Simplicity and clarity*: a good tax system should be simple and clear, so that taxation subjects clearly know the scope of their duties; it turns out that the complicated tax structure often does not bring the intended effect, but it rather creates obscurities (Vančurová, Láchová, 2010, 43-45).

### 1.2.1 Vertical and Horizontal Equity

Another purpose of tax structure should be to help fair distribution of income and wealth in society. There are two types of equity principles which support this thought: vertical and horizontal equity.

*Vertical equity principle* refers to the idea that taxpayers with greater ability to pay taxes should pay more taxes than taxpayers with lower abilities to do so. For this purpose, progressive taxes are used, and they have a *redistributive* effect. In other words, if the wealthier subjects pay more taxes in proportion to their income, this is known as a proportional tax, however if they pay an increasing proportion, this is called a *progressive tax*, which is sometimes associated with redistribution of wealth.

*Horizontal equity principle* is a principle that requires taxpayers with the same or similar financial abilities to pay the same tax amount, regardless of their gender, race or age. This principle requires, for example, all sources of income to be added together, and the taxpayer's total income should be the subject to taxation (Peková, 362).

In the following paragraphs of my diploma thesis, I will elaborate on the tax system of the Czech Republic.

## 2 Tax System in the Czech Republic

Until the year 1993, the Czech Republic was the part of the sovereign state of Czechoslovakia. In 1993 the Republic made a peaceful dissolution from Slovakia, and became an independent country. Naturally, certain taxation system reforms had been made, in order to reach the following goals:

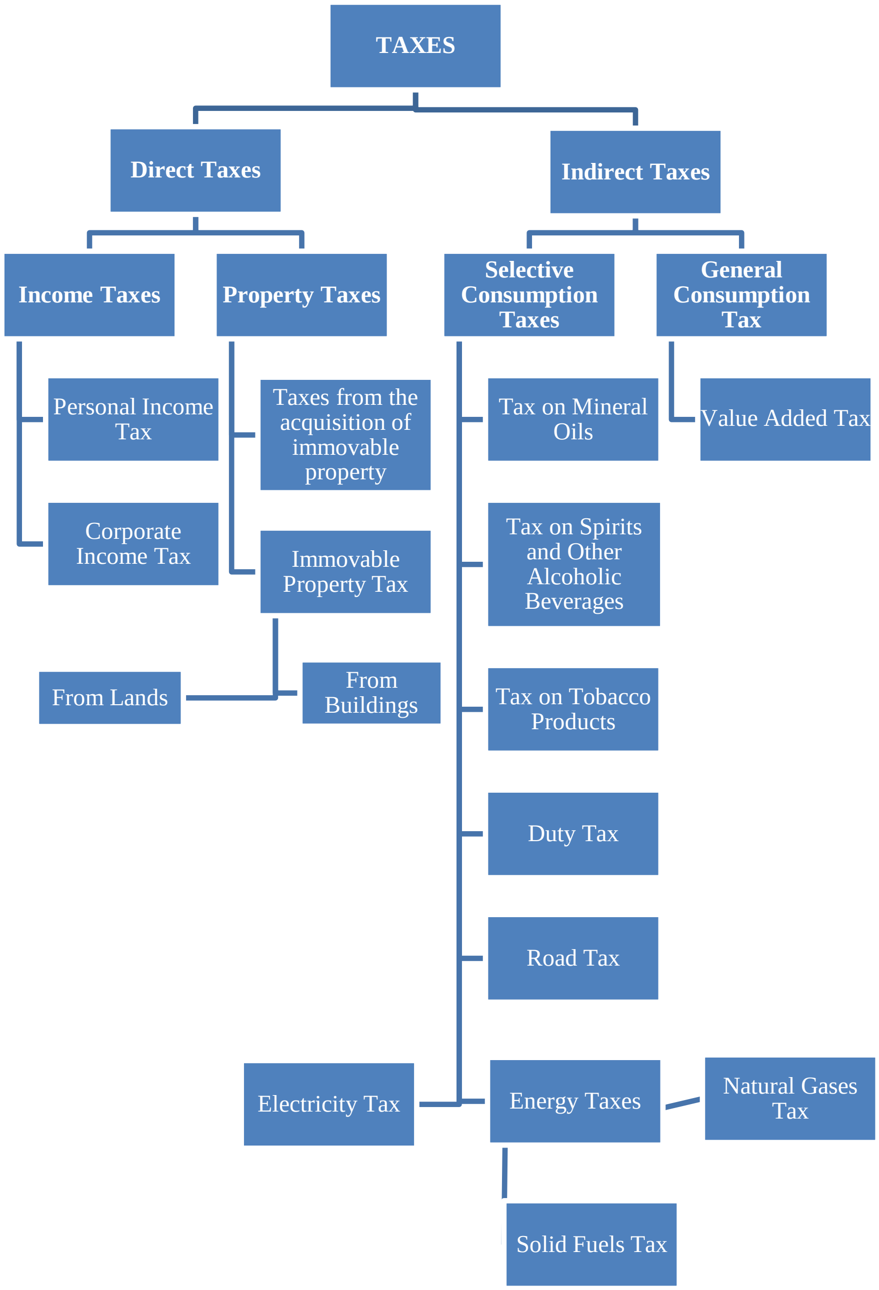
- To make the taxation system simpler and more applicable solely to the Czech Republic,
- To make the system more transparent,
- To increase tax fairness,
- To establish basic conditions for the beginning of the European tax system and the Czech Republic unification process,
- To ensure sufficient budget revenue and tax system flexibility to be able to adapt to various economic changes (Široký, 36).

Czech Republic has a very similar tax system to the ones of developed Western European states. The laws of the Czech Republic’s tax system were drawn up at the beginning of the 1990’s and they came into force in 1993. Only excise duties and value-added tax were adjusted in 2004, which was the year when the Czech Republic joined the EU. Tax laws are not always easy to follow since they are frequently subjected to various modifications (Taxes: Tax system in the Czech Republic). Taxes are most commonly divided into direct and indirect taxes (Široký, 39).

For a clearer and better understanding of tax classification, I have created a detailed graph presented below (Graph 1), which illustrates the tax division in the Czech Republic.

As the graph suggests, taxes are divided into two main categories: direct and indirect taxes. These two categories are furthermore split into various sub-categories - direct taxes are divided into income and property taxes, and indirect taxes are divided into general consumption and selective consumption taxes. The graph further informs us that there are two types of income taxes - Personal Income Tax (PIT) and Corporate Income Tax (CIT).

**Graph 1:** Tax System of the Czech Republic




(Source: Graph made on my own based on information collected from "Daňový systém ČR 2014")

Additionally, we can see that property taxes are divided into immovable property taxes from land and from buildings, and taxes from the acquisition of immovable property. Selected consumption taxes are taxes from mineral oils, spirits, tobacco products, duty tax, road tax, and energy taxes, which consist of electricity taxes, solid fuels tax and natural gases tax. General consumption tax consists of only one subgroup, which is the Value-Added Tax (VAT).

For a better understanding, I will provide more detailed explanation of the meaning of these types of taxes in the upcoming paragraphs. I will begin by explaining the direct taxes, and further continue with the explanation of indirect taxes.

## 2.1 Direct Taxes in the Czech Republic

Direct taxes are usually in the center of attention of any taxpayer. In contrast to direct taxes, of which we are aware of, indirect taxes are rather hidden in prices and they create a sort of an additional, continuous item. In the case of direct taxes, we are sharing a part of the outcome of our efforts, such as our income, earnings or overall economic results, with the country we are residing in (Dvořáková, 34).

Direct taxes depend on an individual's income (Czech Republic: Taxes); they are directly paid to the government by the taxpayer on the basis of taxpayers' income or property. The subject cannot avoid direct taxation, and it cannot transfer it to other economic entities. In many cases, the subject can pay and calculate the tax amount on his or her own, or at least is aware of the amount (from a payroll for instance) (Široký, 40).

As previously mentioned, direct taxes are divided into income taxes and property taxes. Income taxes are subdivided into PIT and CIT.

### 2.1.1 Personal Income Tax

*Personal Income Taxes* are considered to be the most important in terms of fair taxation and from the perspective of economic efficiency. PIT is often criticized for its progressive nature and it is often highlighted due to the inefficiency of high taxation applied on higher incomes. Subject to personal income tax is the achieved income per taxation period. According to the criteria, high rates applied on the highest incomes are extremely unstimulating, since they discourage taxpayers from work and other economic activities, and they encourage tax evasion (Medveď, 18-19).

In order to better understand the characteristics of this tax type, it is important to know its technical structure. In summary we can say that the personal tax obligation (or the tax amount) is being accumulated as follows: taxable incomes from all sources are summed up, and from this sum all the tax reliefs and discounts are being deducted in the form of deductible items (tax discount on all dependent children for example). The resulting tax base is by law taxed in such a manner, so that it is progressive, meaning that higher incomes have higher average burden. The calculated tax amount may be further reduced by certain additional tax reliefs in the form of taxes and the overall result is the tax amount, which needs to be paid by the taxpayer (Kubátová, Vítek, 153).

During the two hundred years of its existence, the personal income tax has earned a significant position for characteristics supporting equity and efficiency of tax systems. Some of the most important properties of this tax are:

- It corresponds to solvency principle
- Tax revenues are flexible
- It does not cause price distortions
- It is transparent

*The solvency principle* is one of the main principles of fair taxation and in practice it is shown in the progressive tax burden. With the progressive PIT, it is possible to redistribute income among different members of society, and in such a way get a fair distribution. However during the last decades taxation, according to the size of income, became the subject of criticism. The critics say that a fair base for taxation according to the solvency principle is consumption (expenditure) of the taxpayers (Kubátová, Vítek, 154).

*Flexibility* of PIT revenue means that economic growth is reflected in the growth of personal incomes and the shift of taxpayers to higher tax bandwidth, therefore tax revenues are growing relatively quickly. Taxpayers do not see this property as an advantage, because they are losing an increasingly higher share of their earnings; this nonetheless enables a greater stability of the public budget and it gives governments more space for decision-making. In the period of growth of inflation, tax flexibility can become an instrument leading to “impoverishment” of the taxpayer, since as a result of the progressivity of rates, on nominally higher earnings a relatively higher tax burdens are imposed, even though in reality incomes do not get much higher, or in the majority of cases they stay the same, if not lower.

PIT *does not create price distortions*. Tax imposed on incomes does not have a primary effect on the prices of goods and services and it does not cause inefficiency. It is nevertheless frequently criticized for causing distortions between the work utility and leisure time utility, especially if its progressiveness exceeds the carrying capacity. Neoconservative economics consider the substitution effect of PIT as a great barrier for further growth. Moreover, the PIT progressivity is increasingly becoming the subject of criticism in terms of tax fairness. It is pointed out that the more “diligent” taxpayers should not be punished by having to pay higher taxes, and that the tax should be more proportionate. Linear taxation proposals are present in developed economies with higher standards of living, because in countries with overall lower incomes is not possible to achieve a very high profit with a single tax rate. In the past, progressiveness actually was an instrument used for obtaining a sufficient profit when other resources were limited (Kubátová, Vítek, 154).

PIT is *transparent*, and the amount of the tax burden is evident. Unlike indirect taxes PIT, as a direct tax is much more transparent, since when it comes to indirect taxes taxpayers do not have much information about it, since they do not pay the taxes personally, and it is also not completely clear who is the tax bearer. PIT is the only tax, where practically anyone can calculate the tax burden of any hypothetical income, and therefore the taxpayers can compare their idea of fair redistribution with what they are being offered by the government. Additionally, even governments themselves have the possibility to construct the tax in order to meet the preferences of their voters. Also, the fact that most of the taxpayers are able to at least approximately estimate the amount of their annual income tax speaks for itself, while when it comes to indirect taxes, which are paid in the prices of goods and services, taxpayers are not really aware of the total annual amount (Kubátová, Vítek, 155).

When it comes to PIT rate in the Czech Republic, from 2008 until today's date nothing changed. The personal income tax rate remained constant, at 15% for the mentioned time period (Vývoj sazby daně z příjmů fyzických osob).

### 2.1.2 Corporate Income Tax

During the recent decades there have been theoretical debates whether corporate income taxes are indeed necessary. Owner of a legal entity is in fact always a natural person, and that is why it would be possible to perhaps completely remove this tax type and impose it at the moment when the income would become the earning of the actual owner (Vančurová, Láchová, 2010, 83).

CIT together with PIT and certain indirect taxes (VAT for instance), is considered to be one of the most important and the most interesting tax types. Nonetheless currently this tax is extremely controversial since there are variety of opinions in regards to its existence and structure. Historically speaking, CIT belongs amongst one of the youngest tax types. The implementation of this tax type became possible only when a more developed accounting came into existence, and when the principle of the so-called net income was accepted. Gross income tax was the tax type from which the today's CIT developed from (Kubátová, Vítek, 178).

*Subjects* to CIT are legal entities; this type of tax is imposed on their profits. It is often debated that the CIT does not have an economic justification, since all corporate profits after all become personal incomes, thus the subject of personal income taxation. As a result, revenue of this tax is usually low.

There are certain disadvantages connected to this type of taxation:

- Legal entities do not have a distinctive taxable capacity, it would be sufficient to tax personal incomes,
- Legal entities are shifting taxes to other entities,
- It is difficult to define a "taxable income" therefore tax is not neutral,
- A problem of double taxation occurs,

However, there are significant arguments in favor of this type of taxation:

- Legal entities pay for public services,
- It compensates for the limited liability of legal entities,
- CIT taxes profits which on the personal-level taxation would not be subject to taxation (Medveď, 19-20).

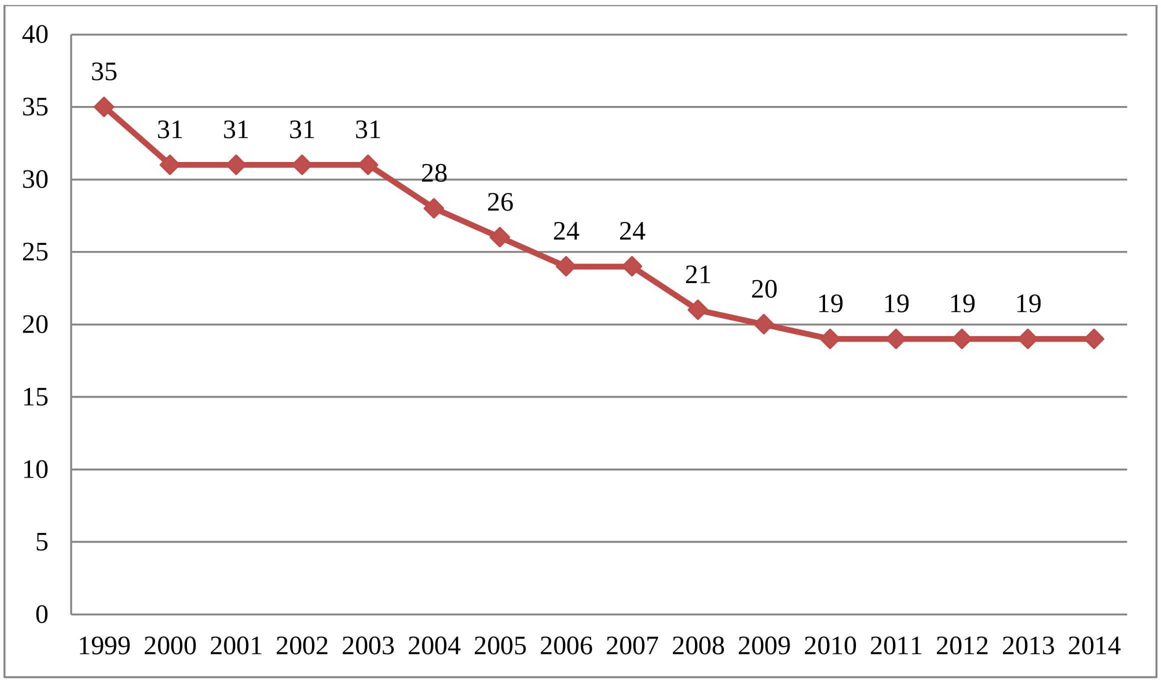
Common reason for the existence of this type of taxation is that legal entities (corporations, companies), as well as natural persons, have legal subjectivity, and should therefore pay taxes similarly to natural persons. Additionally, there are two arguments which are in favor of existence of this type of tax. Firstly, because the legal persons in comparison to natural persons have the benefit of limited responsibility (liability), and therefore should pay for this kind of benefit in the form of taxes. The second argument for the existence of CIT is the sole fact that companies utilize certain services provided by the public sector, which are provided either for free or at much lower market prices. For using these services legal entities should pay the price, which are taxes (Kubátová, Vítek, 177).

Taxpayers of the CIT are legal entities; when it comes to legal entities which have a registered office or a place of management on the territory of the Czech Republic, the legal entity may either be resident or non-resident taxpayer. According to the purpose of the establishment of the legal entity, the taxpayer is either a business-related or a non-business-related entity. A resident is any legal person who has a registered office or a place of executive management on the territory of the Czech Republic. Resident taxpayers have unlimited tax obligation, meaning that incomes earned in the Czech Republic, as well as abroad - therefore worldwide incomes, are subjected to taxation. Non-resident taxpayer is a legal entity with a registered office or a place of management abroad. Non-resident taxpayers have partial tax obligation, and they are subjected to income taxation only on income which they earned on the territory of the Czech Republic (Vančurová, Láchová, 91-92).

In order to help us better understand the evolution of the CIT rate in the Czech Republic during the time period from 1999 until today, I have made the Graph 2 presented below. As the graph suggests, in the year 1999 the CIT rate reached 35%. Ever since, the tax rate started declining; in the year 2000 it declined to 31% and remained constant until 2003. After 2003 it continued declining further; in 2004 it dropped by 3%, to 28%, and in 2005 it further dropped by

2% to 26%; it continued dropping in the following years as well, and in 2006 until 2007 it remained constant at 24%. In 2008 it dropped by 3% to 21%; it continued declining even in 2009, when it reached 20%. In 2010 the CIT rate further declined to 19%, it remained constant and it is still the same until the current date.

**Graph 2**: Czech Republic Corporate Income Tax Rate (1999-2014)




(Source: graph made on my own based on information gathered from www.ucetnikavarna.cz)

### 2.1.3 Property Taxes

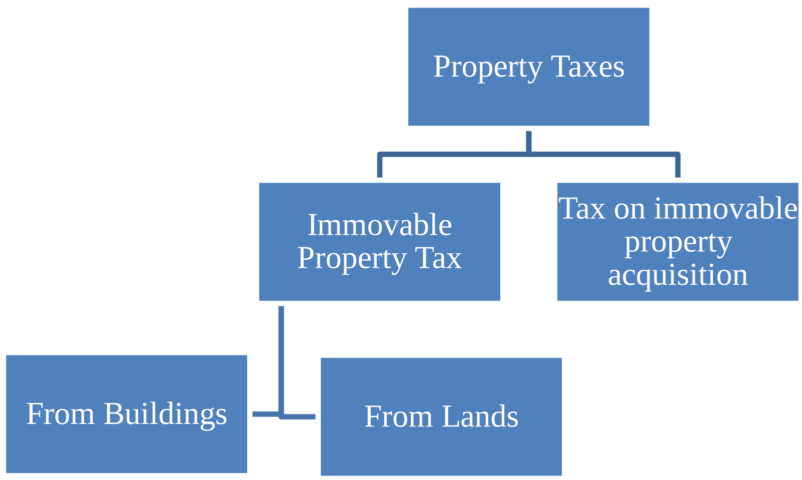
*Property tax* had been used in the ancient times, but today it represents additional contribution mainly used at the urban and regional levels. This group includes two types of taxes: taxes paid regularly and taxes paid irregularly. The first type of taxes applies to property tax, and the second type applies to inheritance, gift tax and other taxes on capital transfers. Property taxes take into consideration payment capacity of the taxpayer, and therefore theoretically contribute to increased horizontal and vertical equity, thus the following positive features:

- Property tax increases the progressivity of the tax system,

- In contrast to income tax, it does not have discouraging effects,
- It leads the taxpayer to a more rational assets management,
- It respects the utility principle.

The following graph illustrates the structure of the property taxes in the Czech Republic. As we can see, they are divided in a very clear and simple way - into taxes on acquisition of immovable property and immovable property taxes. Immovable property taxes are furthermore divided into taxes from lands and taxes from buildings.

**Graph 3**: Property Taxes in the Czech Republic




(Source: my own graph based on the information gathered from "Daňové zákony 2014).

Majority of property taxes have a progressive impact due to the higher consumption by the wealthier subjects, and this fact is to a certain extent affected by the tax rates. Immovable property taxes particularly create an important part of municipal revenues. These types of taxes are nonetheless also associated with negative contexts:

- Double taxation creation: a tax on a property which was bought with an income that was already subject to PIT,
- There is an inequality in the taxation of movable and immovable properties,
- It may have a negative impact on savings (Široký, 145).

Subjects to land tax are lands located on the territory of the Czech Republic which are on the cadastral map of the cadastral office of the given territory. Subject of building tax are buildings which have been issued a certificate of occupancy, as well as apartments and commercial spaces. The land tax base can be the price of the land or actual land area in square meters, the tax rate is set as a percentage or in Czech crowns (CZK) per square meter. The building tax base is the building area or in other words the building plan above ground in square meters (Široký, Daně v Evropské unii, 233).

Collection of property taxes is relatively simple. Obligation to pay these taxes arises in case of the existence of proprietary or user-relationship towards a certain property or in case of property acquisition. Payment of property tax is required regardless of the income of the taxpayer (Vančurová, Láchová, 2014, 349).

## 2.2 Indirect Taxes

*Indirect taxes* are levied and paid in the price of goods, services, transfers or rents. The moment of taxation usually occurs when the commodity is purchased or consumption is made. Regardless of the amount of income or the financial situation of the person, taxes are levied at the same rate for people with high as well as low incomes or wealth. These types of taxes affect subjects indirectly, and therefore often ordinary citizens do not realize their amount (when buying groceries for example). Indirect (sometimes also referred to as consumption) taxes are further divided into *general* (which are imposed on large scale of products or services and this tax is designed as “ad valorem” - meaning that the charge is levied as a percentage of value of the item it is imposed on) and *selective* taxes (Široký, 40).

General or universal indirect tax is the VAT; selective indirect taxes are duty taxes, road taxes and energy taxes which consist of tax on natural gases, electricity tax and solid fuels tax (Vančurová, Láchová, 2014, 60).

### 2.2.1 Selective Consumption Taxes

As the name suggests the subject of taxation of selective consumption taxes is limited to certain selected commodities. In taxation system of the Czech Republic we can find this type of taxes in the form of duties; consumption of five groups of selected products: mineral oils, spirits, wine and its intermediate products, and beer and tobacco products, is also subject to consumption taxes, and so is the energy tax. The energy is a fairly new tax type implemented in 2008 into the Czech taxation law. The purpose of this tax is primarily environment protection. There are three types of energy taxes: tax on natural gases, tax on solid fuels, and tax on electricity (Vančurová, Láchová, 2010, 231).

To a certain extent, *road tax* has the characteristics of a consumption tax, and according to the Organization for Economic Co-operation and Development (OECD), it is classified amongst consumption taxes on the use of certain products, in this case the use of vehicles. Currently, within the European Union, ecological aspects of the taxation of motor vehicles become significantly more important. On the other hand, in terms of the definition of tax entity as well as taxation period, to a large extent road tax also has the characteristics of a direct tax. In the Czech Republic, this type of tax is aimed at individuals who use their vehicles on roads in order to make a profit, in other words for doing business. The goal of applying the road tax is to create financial resources for maintenance, repairs, reconstruction, and development of road networks. Therefore this type of tax is an example of tax fairness (Vančurová, Láchová, 2010, 232).

Subject to the road tax is usually a legal or a natural person who operates the vehicle registered in the Czech Republic, employer who pays his employee’s travel expense reimbursement for use of a personal car, and in the case of car rentals, vehicles which are subjects to road taxation are the ones used for business purposes.

Another selective consumption tax is *duty*. What differentiates duties from other consumption taxes is the fact that it is imposed only upon imported goods. Duty is not a tax from a legal perspective; however from an economic perspective the imported goods are subjects to taxation. By goods we mean any tangible movable property, as well as electrical energy. The specific amount in CZK from which we calculate duty is called the customs value of the tax base, and it is determined not only for the exported but also for the imported goods. The duty rate is determined as a percentage and is differentiated according to the type and origin of the goods (Vančurová, Láchová, 2010, 241).

*Excise taxes* are indirect taxes which are historically the oldest tax type, and ever since the date of their creation, they have always represented a significant source of revenue to the state. The state intentionally burdens sales or consumption of a selected group of products. A reason for the implementation of such burden is particularly the contribution to the state budget. Excise taxes are very stable and relatively well predictable resources thanks to low prices and demand elasticity for most products which are subjects to this tax type. Subjects to excise taxation are often products which negatively affect public health or the environment. As previously mentioned, these products are mineral oils, spirits, wine and its intermediate products, and beer and tobacco products (Vančurová, Láchová, 2010, 244).

### 2.2.2 Value Added Tax

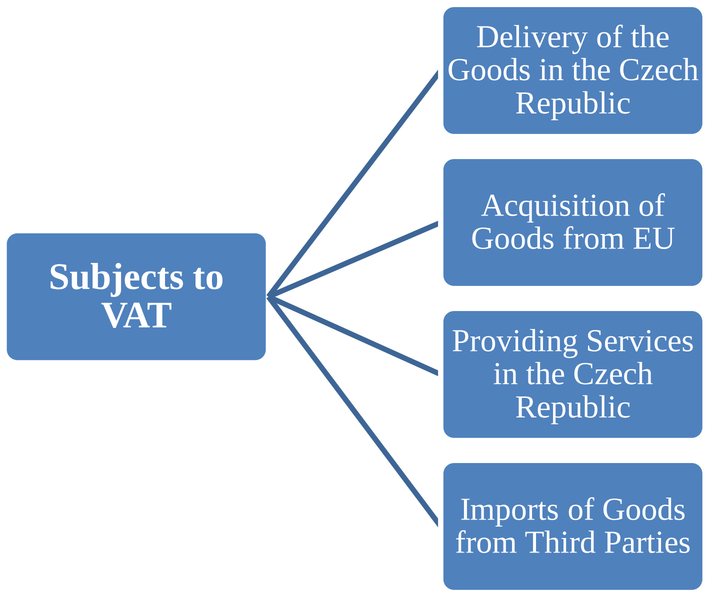
VAT is an indirect general consumption tax which foremost burdens the end consumer - the personal consumption of citizens and the state, as well as the organizations established by the state and other entities that do not necessarily have to perform economic activities. VAT is paid by taxpayers, who actually are entities registered for VAT, since this type of tax is being levied in parts during various stages of production, sales and distribution of goods and services (Havel, 3).

VAT is an obligatory tax in all European Union (EU) countries. It is a tax which progressed fairly far in terms of its harmonization within the EU member states. The main idea of the functioning of the VAT is simple. The tax is levied at each manufacturing stage, however not from the whole turnover; thus only the value added is taxed.

Costs associated with labor and profit margin form the VAT. However a clear definition of a newly created value in the level of a single subject is fairly difficult and expensive to determine. Therefore, the VAT amount is determined indirectly. Each tax entity is obliged to tax all of their outputs (Vančurová, Láchová, 2014, 288).

The Graph 4 presented below illustrates how subjects to VAT are divided in the Czech Republic. According to the graph, we can conclude that in the Czech Republic, subject to Value Added Tax is the delivery of goods in the Czech Republic, acquisition of the goods which are located outside of the EU, services provided in the Czech Republic, as well as imports and acquisition of goods from the third parties, meaning countries outside of the territory of the EU.

**Graph 4**: Subjects to VAT in the Czech Republic

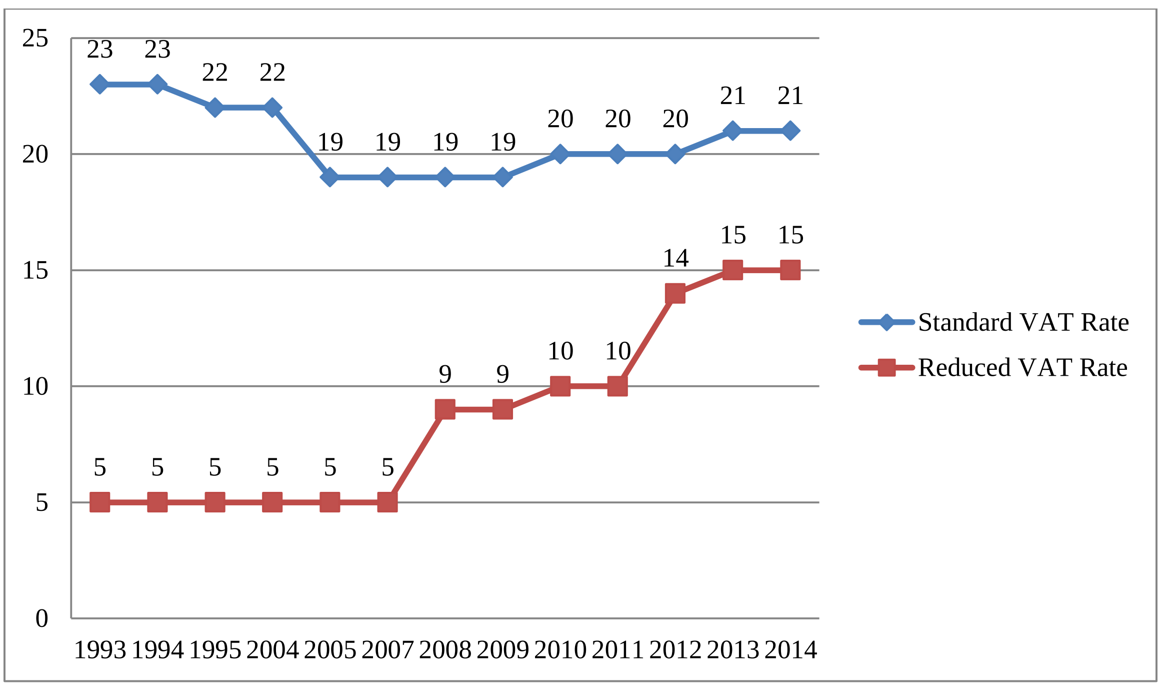



(Source: my own graph made according to the information gathered from “Daňový systém ČŘ 2014).

Goods are tangible assets excluding money and securities. They are therefore tangible movable and immovable assets, heating, electricity, gas, water as well as the right to build (when the owner of the land legally converts the right to build a property to another person). Delivery of goods is the transfer of the right to regulate, as the owner of the goods, which is usually done for a fee. We will not find the definition of “services” in the Value Added Tax Law, however the provisions of services are considered to be economic activities other than delivery of goods (Vančurová, Láchová, 2014, 291).

In the Graph 5 below we can see the development of the Value Added Tax rate in the Czech Republic in the time period from 1993 until 2014. As the graph suggests, both standard and reduced VAT rates were not constant throughout the mentioned time period. We can notice that the standard VAT rate did not change drastically. It reached 23% in 1993, and it remained at the same percentage rate throughout 1994. Afterwards in 1995 it dropped by 1% to 22% and it remained at the same percentage rate until the year 2004. In 2005 it dropped further, to 19%, and it stayed the same until the year 2009. In the following year it rose to 20% and it did not change until 2013, when it rose to 21%. There are no changes in VAT rates in the current year 2014. Additionally, if we take a look at the development of the reduced VAT rate, we can notice that there were more changes than in the case of the standard VAT rate. We can see that since 1993 until today, the standard VAT rate is three times higher – it rose from 5% to 15%. From 1993 until 2007 the standard VAT rate remained the same, at 5%. Afterwards in 2008 it rose to 9%, and it remained the same until 2010 when it again rose, to 10%, and it remained constant until 2011. In 2012 the standard VAT rate rose again, to 14%, and in 2013 it rose again by an additional 1% to 15%. The reduced VAT rate remained the same in the current year.

**Graph 5**: Development of the VAT Rate in the Czech Republic (1993-2014)




(Source: graph made on my own based on the information gathered from www.danarionline.cz)

## 2.3 Tax Mix

Tax mix is a tax system feature. It is an indicator which shows which types of taxes certain states give preference to, and which taxes they are likely to rather suppress. The importance of taxes is usually measured by its share of income in regards to the total tax revenue. During the last decades, income tax share in tax mixes of developed countries is gradually decreasing. This is happening at the expense of consumption tax share increase. These taxes have a less negative effect on economic activities. This certainly also applies to the Czech Republic.

In order to provide a better understanding of the tax mix, I have made the Table 1 presented below. It represents the evolution of the national tax collection of specific taxes as well as tax mixes in the Czech Republic for the past three years. The table provides amounts of each tax and it summarizes their values for each year.

**Table 1**: National Tax Revenue (2010-2013) (in billions of CZK)

| Year | 2011 | 2012 | 2013 |
|---|---|---|---|
| **Social Security Insurance** | 357.92 | 377.77 | 372.18 |
| **Value Added Tax** | 275.39 | 212 | 219.96 |
| **CIT** | 118.11 | 84.30 | 81.48 |
| **PIT** | 133.37 | 98.10 | 94.49 |
| **Consumption Taxes** | 146.58 | 142.20 | 136.45 |
| **Duty** | 7.70 | 1.00 | 1.46 |
| **Property taxes** | 11.72 | 9.70 | 9.08 |
| **Road Tax** | 5.19 | 9.54 | 9.85 |
| **Real Estate Tax** | 8.57 | 11.10 | 9.08 |
| **Other Taxes** | 3.49 | 2.44 | 8.17 |
| **Total** | 1 067.66 | 1 084.02 | 1 091.86 |

(Source: MF ČR, my own preparation based on the information gathered from www.mfcr.cz)\

If we take a closer look at the table, we can notice that there have not been major differences in regards to the total national tax revenue amount. We can notice that the numbers throughout 2011, 2012 and 2013 do change, however not in a drastic manner. We can observe that the amounts slightly increase from 2011 onwards. Additionally, we can see that the biggest amounts are accumulated from social security insurance. The table shows a raise of social security insurance revenue in 2012 in comparison to 2011, however there has been a fall in 2013 in comparison to 2012. Another interesting figure is VAT. We can notice a fall in 2012: 212 billion CZK, while the amount in 2011 was 275.39 billion CZK. In 2013 there has been a slight increase in comparison to 2013 – the amount was 219.96 billion CZK.

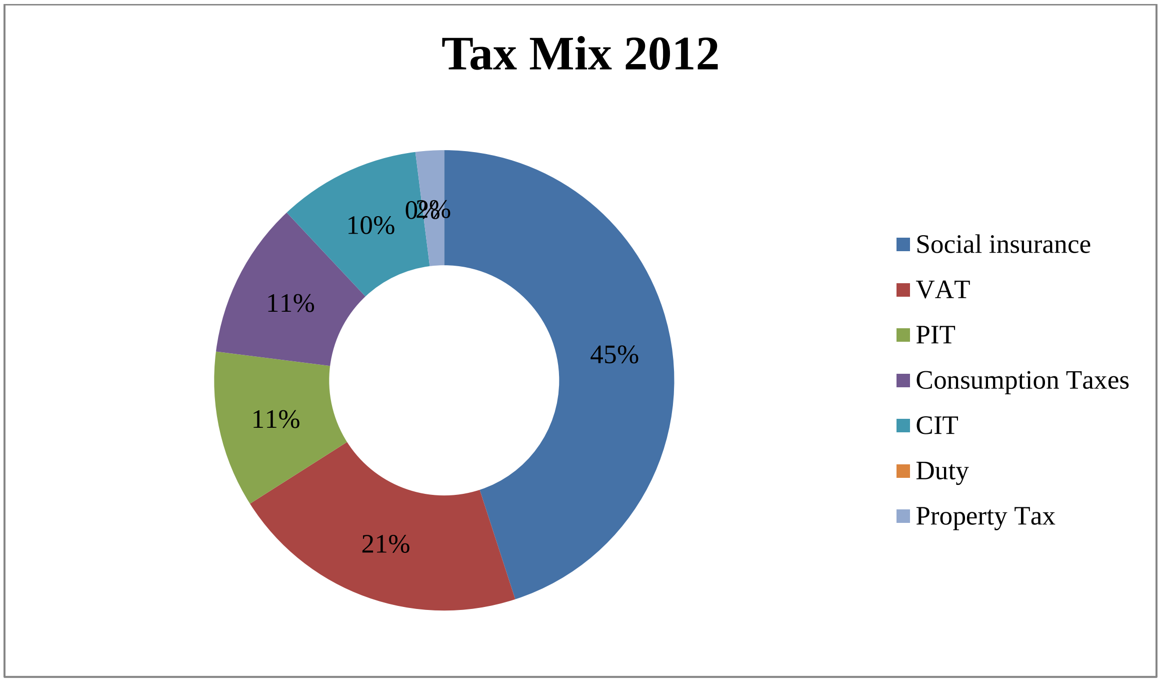
CIT revenue has marked a change as well. The figures from the table show that in 2011, total CIT revenue was 118.11 billion CZK. If we compare this figure with the ones from 2012, we can notice a significant revenue fall – the amount was 84.30 billion CZK. Figures from 2013 do not differ as much from the ones from 2012. There has been a fall nonetheless, since the total CIT revenue amount in 2013 was 81.48 billion CZK.

PIT figures also marked a significant decrease, as did CIT. The figures are showing 133.37 billion CZK in 2011, 98.10 billion CZK in 2012, and 94.49 billion CZK in 2013. Consumption taxes data are showing a decrease: 146.58 billion in 2012, 142.20 billion in 2012 and 136.45 billion in CZK. Real Estate Taxes are showing an increase from 8.57 billion CZK in 2011 to 11.10 billion CZK in 2012, following by another decrease in 2013 to 9.08 billion CZK.

As it has been shown in the Table 1, social insurance taxes, VAT, CIT, PIT and consumption taxes generated the highest amounts into the state budget of the Czech Republic. The rest of the taxes do not accumulate such significantly high amounts into the state budget, they are important nonetheless. It is interesting to notice that duties marked a significant fall in 2012 and 2013: from 7.70 billion CZK in 2011 to 1 billion CZK in 2012. In 2013 there had been a slight increase in comparison to 2012, since the amount was 1.46 billion CZK. When it comes to property taxes, the data show a decrease from 11.72 billion CZK in 2011 to 9.70 billion CZK in 2012, and an increase in comparison to 2012 to 9.08 billion CZK in 2013. Road Tax is showing an increase from 5.19 billion CZK in 2011 to 9.54 billion CZK in 2012, and 9.85 billion CZK in 2013.

In order to furthermore elaborate on the tax mix in the Czech Republic, I have made the Graph 6 presented below. It is interesting to observe which types of taxes are the most important for the country - the ones which make the highest contribution into the state budget. As the graph suggests, the highest share of the tax mix in the Czech Republic belongs to the social insurance taxes, which make 45% of the total tax revenue. Another very important tax type is VAT, which brings 21% to the total state budget. PIT and consumption taxes make 11% each, while CIT contributes with 10%. Other taxes are not of a huge importance for the Czech Republic since they make a very low, or in the case of duty tax –no revenue with 0%.

**Graph 6**: Tax Mix in the Czech Republic



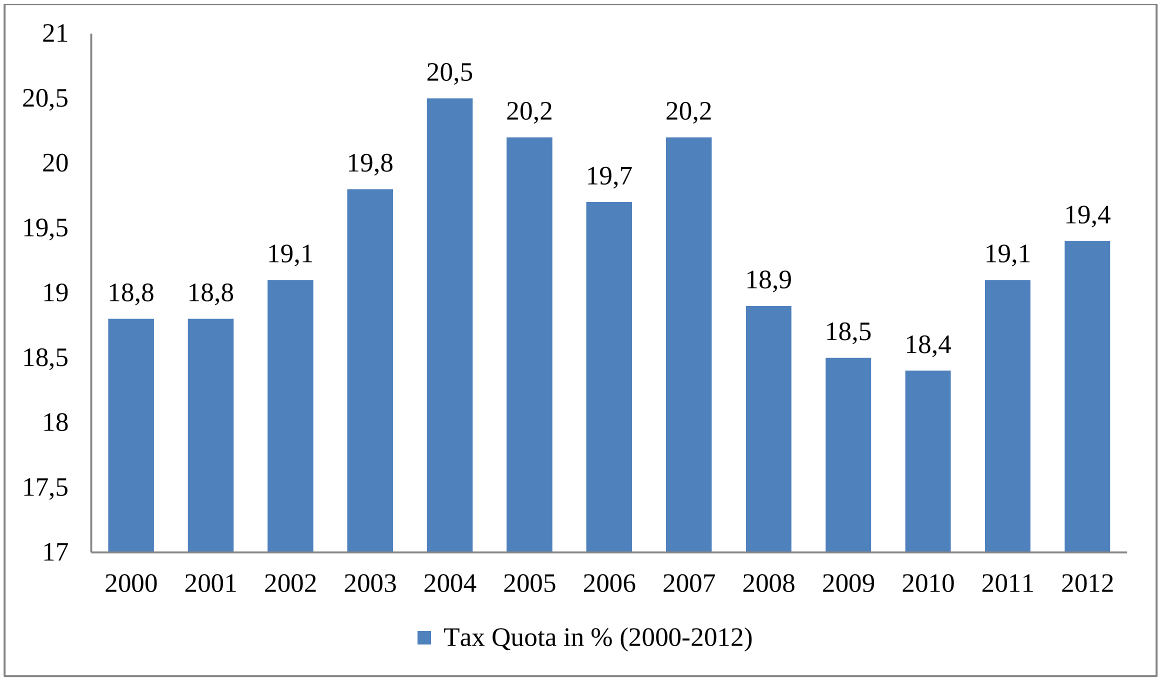

(Source: my own graph based on the information gathered from Eurostat and OECD)

## 2.4 Tax Quota

In addition to tax mix, there is another indicator used for international comparisons called the tax quota. It is a macroeconomic indicator which shows the proportion of selected taxes to Gross Domestic Product (GDP). It shows how big of a proportion does not remain to those who had part in creating the tax income, and it is divided by public funds according to taxation principles (Vančurová, Láchová, 2014, 46).

Net quota includes only taxes in the legal sense; compound quota additionally contains other compulsory deductions corresponding to economic concept of taxes, such as for example, incomes from compulsory social security contributions. In the net quotas, for instance, social security contributions are not included. Furthermore, simple tax quota is simply the sum of all payments contributed into the public budget (Vančurová, Láchová, 2014, 47).

**Graph 7**: Tax Quota Development in the Czech Republic (2000-2013)




(Source: my own preparation based on the information gathered from ec.europa.eu)

Graph 7 presented above illustrates the development of the simple tax quota in the Czech Republic in the time period from 2000 until 2013. As we can notice, in the year 2000 the tax quota was 18.8%, and the following year it remained the same. After 2001, the tax quota was gradually raising: 19.1% in 2002, 19.8% in 2003 and 20.5% in 2004. After 2004, there was a decrease in the tax quota for the following two years: 20.2% in 2005 and 19.7% in 2006. In 2007 there was once again an increase in the tax quota, to 20.2%. In the following three years there was, on the other hand, a decrease in the tax quota of the Czech Republic: 18.9% in 2008, 18.5% in 2009 and 18.4% in 2010. After 2010, the tax quota in the Czech Republic was gradually increasing, as evident from the Graph 7. In 2011 the tax quota was 19.1% and in 2012 it was 19.4%.

From the data provided in the graph we can conclude that the development of the tax quota in the Czech Republic is not very stable. Also, we cannot actually notice that there is a significant long-term trend which would ensure a stable and, for taxpayers, positive development in the tax burden in proportion to the country's GDP.

## 2.5 Tax Reliefs

Other important elements of the tax structure are various tax reliefs and discounts. They reduce the basic tax amount, or better said they are deducted from the total calculated tax amount. Tax reliefs are divided into two main categories. They can either be absolute or relative or at the same time standard or non-standard. Absolute tax relief is a fixed amount, while the relative tax relief is usually a given percentage. The standard discount or relief, same as in the case of tax deductions, may be applied only in case all legal requirements ale fulfilled. Non-standard discounts, on the other hand, have to be supported by relevant total expenses (Vančurová, Láchová, 2014, 30).

There are different kinds of tax reliefs and deductions in the Czech Republic. For instance, in the case of *corporate income taxation*, there is a tax relief in the framework of investment incentives. It is a part of the government policy of investment incentives aimed mainly at foreign investors, in the form of tax holidays. Another type of tax relief supports employers who employ people with disabilities. This is an absolute type of relief provided in accordance to the degree of disability of the employee. The number of employees with disabilities is essential for the calculation of this type of tax relief. The relief is amounted to 18 000 CZK per one employee with a disability; however in case the employee has more severe disabilities, the amount of discount increases to 60 000 CZK (Vančurová, Láchová, 2014, 144-145).

Furthermore, in the Czech taxation system, there are also different kinds of reliefs and discounts in regards to the *personal income taxation*. Within the scope of taxpayer reliefs, there are three types of reliefs: a basic tax relief, tax reliefs based on disabilities, and student tax reliefs. The basic tax relief is always applied on the total annual amount. The purpose of this relief is to provide minimum untaxed income for each taxpayer. From the year 2008 each taxpayer had the right to apply for this type of tax relief, nonetheless this changed in 2013. From the mentioned year, pensioners who receive their pensions on the first day of the taxation period are not able to use this type of tax relief. When it comes to tax reliefs based on disabilities, it varies in accordance to the degree of disability. Student tax reliefs can be applied to taxpayers who are continuously preparing for their future careers. Another condition for this type of relief is the student's age, where the student needs to be less than 26 years old.

Another type of tax relief in the Czech Republic is a tax relief on dependents, where social status of the taxpayer depends on how many dependent people to whom the taxpayer has a financial obligation to live with the taxpayer in a common household. Generally, a dependent person is a child, towards whom the taxpayer has a financial duty according to the law, regardless of the child's income, or it is a spouse, who does not have their own income, or has a significantly low income. Discount on a spouse can be applied in case the taxpayer's spouse does not reach an annual income of more than 68 000 CZK (Vančurová, Láchová, 2014, 220-221).

Additionally, in the tax system of the Czech Republic, there are certain tax deductions in regards to VAT. Taxpayers are entitled to VAT deduction only in case they are able to provide an invoice issued by the payer of the VAT or a person registered for VAT in another EU Member State. On the other hand, taxpayers are not entitled to VAT deduction for taxable transactions which are not in the frame of their economic activities, including personal consumption (Vančurová, Láchová, 2014, 339).

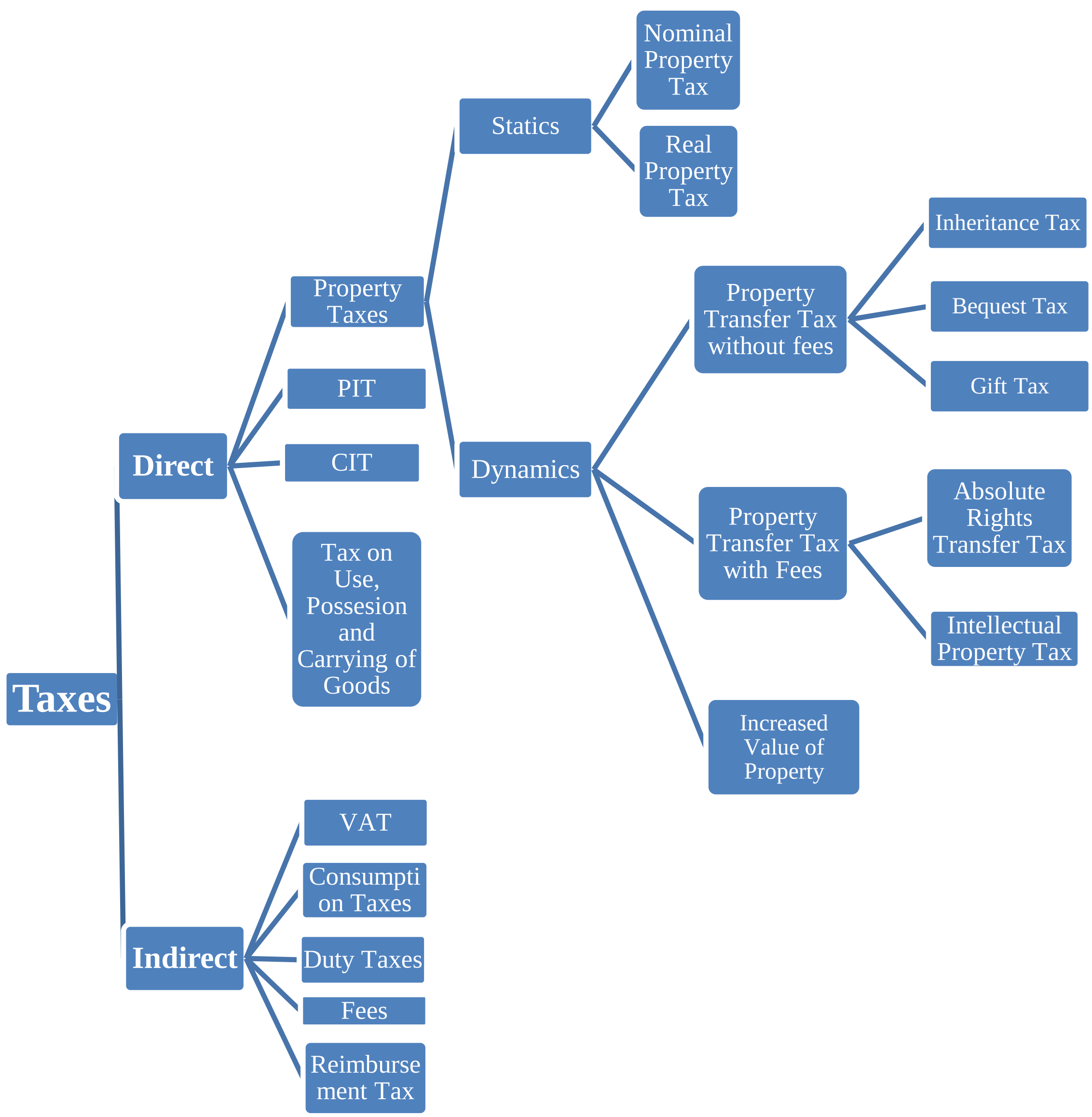
# 3 Tax System in Serbia

During the time period from 2001 to 2005, there have been some important reforms made in regards to public finances, which together with appropriate macroeconomic policies ensured stability and sustainability of the fiscal system in the Republic of Serbia. These reforms increased the influence of public finances and helped achieving macroeconomic stability and sustainable economic growth; they also helped making the fiscal and taxation system in Serbia more transparent, more simple and consistent with the international standards.

A significant progress has been made in establishing fiscal institutions, the elimination of budget deficit, especially in re-defining the role of government in this particular area. The system of public revenue has become simpler, more modern, and most importantly more transparent.

Tax rates, tax exceptions and incentives are implemented primarily to improve the country's economic objectives (Jeremić, 264).

**Graph 8**: Tax System in the Republic of Serbia




(Source: My own preparation based on the information gathered from the www.mfin.gov.rs - Zakoni)

As illustrated in the Graph 8 above, taxes in Serbia are divided into direct and indirect taxes. Direct taxes in Serbia are further divided into PIT, CIT, and taxes on goods which are subdivided into taxes on the use of goods, possession of goods and carrying of goods, and property taxes which are divided into property taxes in statics and property taxes in dynamics. Property taxes in statics are further divided into nominal and real property taxes, and property taxes in dynamics are divided into taxes on the increased value of property, property transfer tax with fees and property transfer tax without fees. The ones without fees include inheritance, bequest and gift tax, and the ones with fees are absolute law transfer tax and intellectual property tax. Indirect taxes are divided into value added tax, consumption taxes, duty tax, fees, and reimbursement tax.

In order to reach a better and clearer understanding of the Serbian taxation law, and the meaning and significance of the previously mentioned taxes in the Serbian taxation law, I will present them and provide explanations in the following paragraphs. I will start with direct taxes, and further continue with indirect taxes.

## 3.1 Direct Taxes

### 3.1.1 Personal Income Tax

PIT system in Serbia has been in force since 2001, and it is regulated by the Serbian Law on Income Taxation. In Serbia a *mixed* system of personal income taxation has been established. All incomes of natural persons are taxed proportionally; additional taxes are levied only in case a taxpayer earns an income over the amount which is previously determined by the law (according to the so-called total annual income of citizens) (Zakon o porezu na dohodak građana, 1).

In Serbia, PIT is imposed in accordance to the type of income of citizens. As illustrated in the Table 2 below, the following types of incomes are subject to PIT: personal earnings, incomes from agriculture and forestry, incomes from self-employment, incomes from royalties and industrial property rights, incomes from capital, incomes from properties, any sorts of capital gains, other incomes, as well as annual incomes.

**Table 2**: Types of Taxable Incomes in Serbia

| TYPES OF TAXABLE INCOMS IN SERBIA | |
|---|---|
| **1.Earnings** | 5.From Capital |
| **2.From Agriculture and Forestry** | 6.From Real Estates |
| **3.From Self-Employment** | 7.From Capital Gains |
| **4.From Copyrights and Related Rights** | 8.Other Incomes |
| | 9. Annual Income Tax |

(Source: My own preparation based on the information gathered from the www.mfin.gov.rs)

An Earning is considered to be a salary which was earned from employment. Earnings are also agreed compensations and other benefits which are achieved by performing temporary and occasional jobs, or on the basis of a contract concluded through youth or student cooperation, except for students who are over 26 years of age. Remuneration, in the form of vouchers, cash certificates and certain types of shares, is also considered to be an earning (Porez na zarade).

Legally, taxpayer of the PIT is a resident of Serbia; PIT is paid on the income which was earned on the territory of the Republic of Serbia, and in another state. A resident of the Republic of Serbia is a natural person who has a residence or business on the territory of the Republic of Serbia, and who resides continuously or intermittently for 183 days or more during a 12-month period commencing or ending in a fiscal year. Additionally, the resident of the Republic of Serbia is a natural person who is sent to another country to carry out work for a legal entity or an individual who is a resident of the Republic and works for an international organization. A taxpayer is also a natural person who is not a resident (non-resident) but earns an income on the territory of Serbia (Zakon o porezu na dohodak građana, 3).

Income from agriculture and forestry is considered to be a cadastral (assumed) or actual income from the activities connected to agriculture or forestry. Taxpayer of the PIT from agriculture and forestry is considered to be a natural person who is the owner or who possesses the rights to use the land registered in the cadaster. This type of taxation is particularly not easy to legally track in Serbia, thus the frequent tax evasions.

Self-employment income is the income generated from business, by providing professional and other intellectual services, as well as income from other (permanent or seasonal) activities. Taxpayers of the self-employment PIT are considered to be natural persons who earn income by performing their own activity, including natural persons who earn income from agriculture and forestry, and any other individual who is subject to VAT.

Income from copyrights is a charge which taxpayers realize based on their written work, voice work, and dramatic, musical and cinematographic works, works of art, conceptual designs, sketches, drawings, translations, proofreading, music performances, and other related works, as well as fine works of applied arts. The fine art works in the field of applied arts are considered to be unique works made by the artists and prepared based on their own ideas, whether it is a draft or material; in the fields of applied arts these works can be plastic pieces of various materials, artistic ceramics, wall paintings, fashion designs, industrial designs and similar. Taxpayer of the PIT on incomes made from copyrights and related rights, as well as industrial property rights, is a natural person who is the author and the holder of related rights, or owner of the rights on the related industrial property who achieves compensations based on the copyrights and related rights or industrial property rights (Porez na zarade).

Capital incomes are considered to be interests on loans, savings and other deposits, on debts and similar securities, dividends and shares of profits, benefits of employees as well as of board members of companies on the basis of profit participation, and the use of the company's services for private use. Incomes from real estates are considered to be incomes which taxpayers earn by leasing a real estate, in particular lands, residential and commercial buildings or parts of these buildings, apartments or parts of apartments, business premises and garages. The taxpayer of real estate PIT is a natural person who earns an income from leasing a particular real estate. Capital gain is considered to be an income which taxpayer earns through sale or other type of transfer with a compensation through real estate rights, copyrights, rights related to copyright and industrial property rights, share of real estates of legal entities, shares and other securities and similar (Porez na zarade).

Other incomes are considered to be incomes which the taxpayer earns from: leasing various equipment, vehicles and other movable properties, profits from gambling, personal insurance, sport, other revenues from service contracts, contracts for temporary and occasional transactions concluded through youth or student agencies for students under 26 years of age, who are receiving education at secondary schools, colleges or universities, collection and sale of secondary raw materials, medicinal herbs, and similar. Annual PIT is paid by natural persons - residents, including foreigners (non-residents) who earned their income in the calendar year (annual sum of all incomes) three times higher than the average annual salaries earned in the Republic of Serbia in the year for which the tax is assessed. Nevertheless, this type of taxation applies to only 1% of the citizens of Serbia (Porez na zarade).

As the Table 3 below illustrates, the tax rates in Serbia for the current year are different for each type of income. The personal income tax on agriculture and forestry, copyrights and related rights, real estate and other incomes is 20%, personal income tax on capital and capital gains is 15%, and on self-employment and earnings it is 10%. In the case of annual personal income tax, income which is up to six times the average annual income is taxed at the tax rate of 10%, and in the case of the amount which exceeds six annual average wages - 10% tax rate is applied on the income up to six times the average annual income and additional 15% on the amount exceeding six annual average wages.

**Table 3**: Personal Income Tax Rates in Serbia

| **Personal Income Taxation in Serbia: 2014 Tax Rates** | |
|---|---|
| **Type of Income** | **Tax Rate** |
| Earnings | 10% |
| Agriculture and Forestry | 20% |
| Self-Employment | 10% |
| Copyrights and Related Rights | 20% |
| Capital | 15% |
| Real Estates | 20% |
| Capital Gains | 15% |
| Other Incomes | 20% |
| Annual Income Tax | 10/15% |

(Source: My own preparation according to the information gathered from http://www.poreskauprava.gov.rs).

### 3.1.2 Corporate Income Tax

CIT is one of the most important forms of public revenues. However it does not have revenue return like VAT and excise duties do; nonetheless it has a development and stabilizing function. According to the regulations of the corporate profit Law of the Republic of Serbia, the taxpayer of CIT is an association, or a company established in one of the following forms: joint-stock company, a limited liability company, partnership, limited partnership, public company, as well as cooperatives, which earn income by selling products or services on the market, or other legal entity (O porezu na dobit pravnih lica).

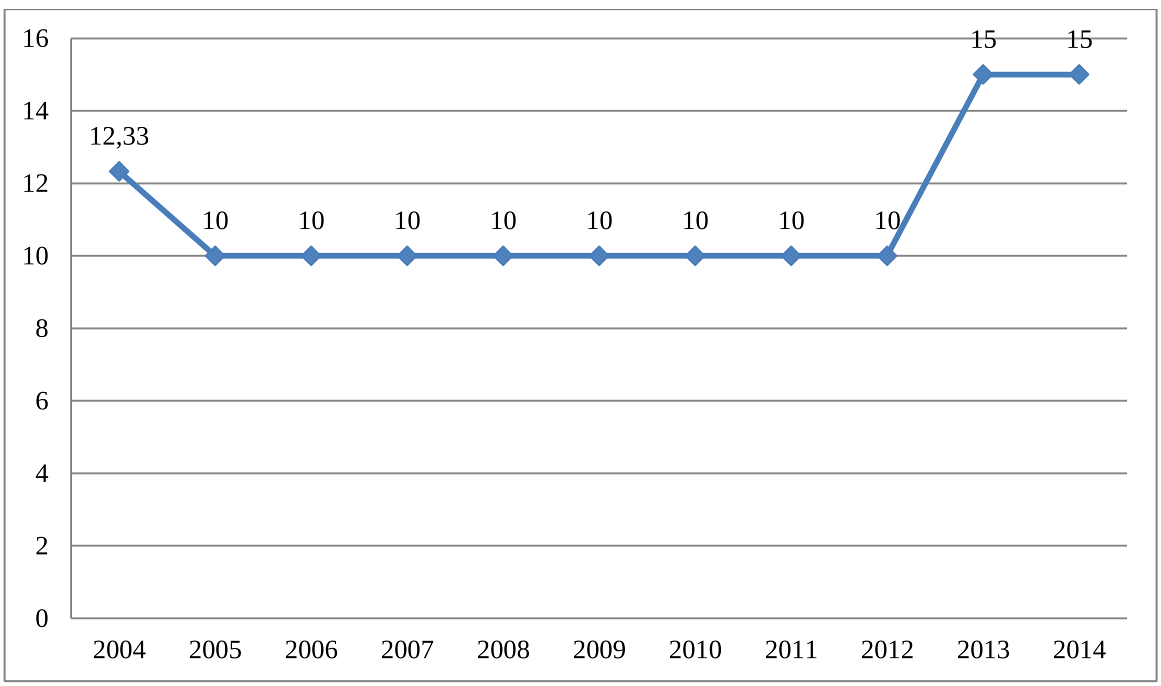
The taxpayer of CIT is a resident of the Republic of Serbia who is subjected to profit taxation earned on and outside of the territory of the Republic of Serbia. Resident taxpayer is a legal entity which established a management and control office on the territory of the Republic. Non-resident taxpayers who made their profits through a permanent establishment situated on the territory of the Republic of Serbia are subjects to taxation as well. A Non-resident taxpayer is a legal entity which established or has a place of effective management and control outside of the territory of Serbia. Permanent business unit is any fixed place of business through which non-residents conduct their business. Permanent establishment consists of permanent or movable sites, constructions or assembled works in case they last for more than six months, in case one of several constructions or mounting projects are being made at the same time, or in case several constructions or assembling projects are being carried out without interruption, one after another (O porezu na dobit pravnih lica).

In case of non-resident and international cooperation, double taxation elimination is very important. For these purposes, certain agreements are made with cooperating countries. These agreements determine which method of avoiding double taxation of company profits applies in the home country, and which in the other contracting state. In doing so, both contracting states may apply the same or different methods. Serbia and the Czech Republic apply the OECD double taxation elimination model. From 2004, the Republic of Serbia and the Czech Republic have a mutual agreement to eliminate double taxation in regards to real estate and personal income taxation (Stakić, Jezdimirović, 161).

The rate of tax on corporate profit is proportional and uniform, at 15%. When it comes to an income earned by a non-resident taxpayer from a resident taxpayer, either from dividends or share in company profits, royalties, interest, capital gains and fees based on the lease of real estate and personal property, the CIT is calculated and paid by subtraction of the tax rate of 20%, unless an international agreement on double taxation avoidance implies otherwise (Siepa).

In order to see how the CIT rate developed in the Republic of Serbia in the time period from 2004 until today, I have prepared the Graph 9 below. We can notice that in 2004, the CIT rate was 12.33%. In the following year, 2005, the CIT rate dropped to 10%, and it remained constant until 2012. In 2013, there had been a change, and the CIT rate rose by 5%, to 15%. The rate remained the same in the current year, 2014, at 15%.

**Graph 9**: CIT Rate in the Republic of Serbia (2004-2014)




(Source: my own preparation based on the information gathered from www.tradingeconomics.com).

### 3.1.3 Property Taxes

Property taxes in Serbia are divided into two categories: property taxes in statics and property taxes in dynamics. Property taxes in statics can only be the basis for tax payment. Static property can also be a source, and in that case we are talking about the so-called ‘real’ property tax.

*Nominal property tax* is one of the oldest taxes in Serbia. It is a regular tax which is paid periodically (quarterly, for example) but not from the property, but from a taxpayer’s income. It is a regular tax, because it charges the net property value expressed in money, whether the property is in the ownership of legal entity or a natural person. One of the key features of this tax is a low and usually proportional tax rate. Stakić and Jezdimirović in their book “Javne finansije” assert that their calculations show that the rate of 1% of this tax type corresponds to 20% of the PIT, and that unlike the nominal property tax, *real property tax* is an irregular tax. This tax is an exceptional tax and it mainly occurs in exceptional situations when it is necessary to secure extremely high assets, therefore characteristic of this tax is its typically high progressive rate (from 10 to 65%, and sometimes even to 100%) (Stakić, Jezdimirović, 140).

In Serbia, property tax in dynamics is classified in accordance to the OECD and IMF classification, and it consists of a tax on the property transfer which includes fees (taxes on financial and capital transactions for instance), which is further divided into transfer tax on absolute law of real estate and securities, and intellectual property rights, and tax on the transfer of property without fees includes inheritance, bequest and gift tax. There is a tax on the increased value of the property which is paid due to increase of the real value of the property without the activity of the taxpayer, as a result of exogenous factors (Stakić, Jezdimirović, 140).

Property tax is regulated by the Law on Property Taxes of the Republic of Serbia. According to this law, all property taxes are divided into three groups: real estate tax, inheritance and gift tax, and tax on transfer of absolute rights. The first tax forms relate to the property in its static aspect, and the other two on the property in its dynamic aspect.

Property taxes are paid on the following property rights: real estate rights, or the ownership right of the land area covering over 10 acres (one acre equals 4047 square meters), the right to residence, right to rent an apartment or residential buildings, for a period longer than one year or for an indefinite period of time, right to lease a construction land which is in public ownership, or agricultural land owned by the state, exceeding 10 acres, the right to use construction lands in public ownership which exceeds 10 acres. Immovable properties are considered to be: lands, residential and commercial buildings, apartments, garages, buildings, and other construction buildings, or some of their parts. The object of the property tax is a legal or a natural person who is the holder of the immovable property rights located on the territory of Serbia (Barać, Stakić, Ivaniš, 141).

## 3.2 Indirect Taxes

### 3.2.1 Value Added Tax

Value added tax is usually defined as a tax which is calculated and paid at all stages of the production and turnover cycle, in a way so that at each stage only the amount of added value which was achieved at that stage of the cycle is being taxed (Petrović, Vićentijević, Stanišić, 95). This tax is named after the fact that participant in the cycle of production and trade pays only for the value which had been added in that cycle. This definition by essence is contained in the Paragraph 2 of the Article 1 of the Law on Value Added Tax of the Republic of Serbia, which says that value added tax is actually a general consumption tax which is calculated and paid on delivery of goods and services in all stages of production and supply of goods and services, as well as the import of goods, unless it is specified otherwise by the previously mentioned Law (Antić, 37).

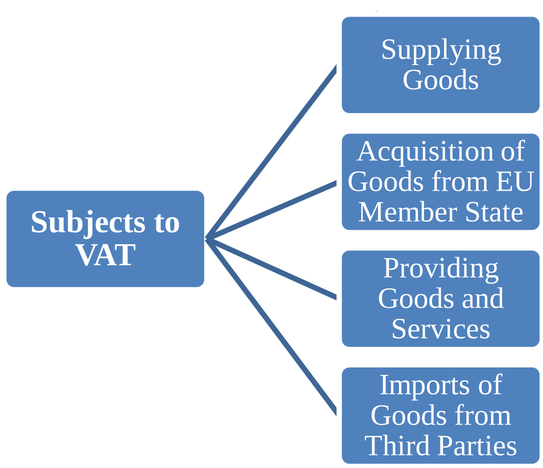
There are two basic methods of calculating the VAT, direct and indirect method. The direct method assumes a direct determination of the value added, which is the tax base. This method, however, generally does not apply due to possible difficulties in its implementation when it comes to higher VAT rates. On the other hand, the indirect method is not intended to determine the value added, or the tax base, but it seeks the immediate calculation of the tax obligation (Popović, 786-790).

In the Serbian Tax Law it is noted that any form of VAT can be based on two principles: the principle of origin and destination. The taxation of added value based on the destination principle means that VAT is payable where it is spent well. Thus, exported goods leaving the country are free from VAT; however they are taxed in the country where they are spent at. In this manner, imported and domestic products are equally competitive on the domestic market (taxation neutrality is the main starting point of the VAT model).

The calculation of the VAT can be applied through three methods: addition, subtraction and credit method. With the addition method, value added is calculated as the sum of payments for labor and capital by which the value added is created. Therefore, the value added tax as a VAT base is equal to the sum of wages, rents, interests and net profits. With the subtraction method, value added is calculated as the difference between total sales of the company and its total purchases, and on that determined base VAT rate is applied. With the credit method, which is a method that is currently used the most, the value added is not calculated; in this case, the taxpayers directly calculate their VAT obligation based on the bills of the purchased goods and services, as well as from bills from the sold products and services (Antić, 148).

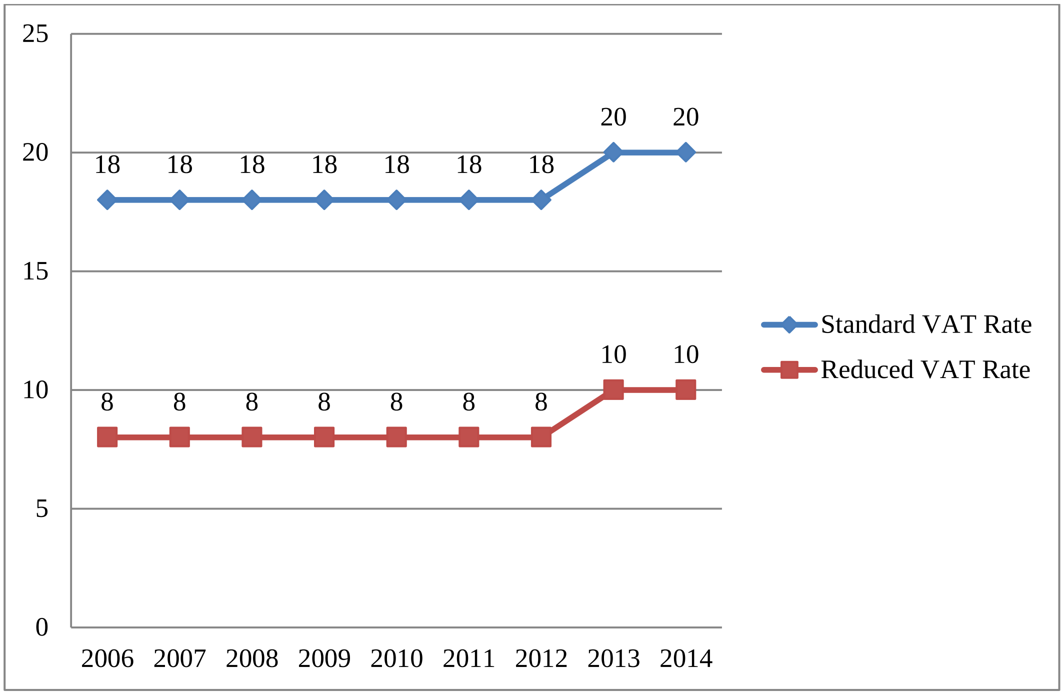
When it comes to VAT taxation, Serbia follows the VAT Directive of the European Union. According to this directive and as we can see from the Graph 10 below, taxable value added transactions in the Republic of Serbia include: supplies of goods, acquisitions within Serbia from EU member states, supplies of goods or services, and imports of goods and services outside of the territory of the EU (third parties). An acquisition of goods on the territory of the EU occurs only when goods are transported from one EU country to another, or when goods sold by a taxable person in the EU country of departure are purchased in another EU country (Council Directive 2006/112/EC, 9).

**Graph 10**: Subjects to VAT in the Republic of Serbia




(Source: my own graph made according to the information gathered from “Porez na dodatnu vrednost”).

**Graph 11**: VAT Rates in Serbia (2006-2014)




(Source: graph made on my own based on the information gathered from siepa.gov.rs)

The Graph 11 above presents the VAT rates in Serbia from 2006 until 2014. As the graph suggests, we can see that the Standard VAT rate in the Republic of Serbia in 2006 was 18%. It remained constant until the year 2012. In 2013 it increased by 2%, to 20%, and it remained constant until today. The reduced VAT rate had a similar pattern, nonetheless at a much lower rate. In 2006 the reduced VAT rate in Serbia was 8%; it remained at the same level until 2012; in 2013 it rose by 2% (similarly to the standard VAT rate), to 10%, and it remained the same until the current year, 2014.

### 3.2.2 Excise Taxes

Excise taxes in Serbia, as a special form of taxation of certain products, were introduced by the Excise Taxes Law. According to this law, goods which are subjected to excise taxes are:

- Petroleum products: all types of gasoline, petroleum, and other oil derivatives,
- Tobacco products: cigarettes; cigars and cigarillos; smoking tobacco and other tobacco products (pipe tobacco, chewing tobacco and snuff),

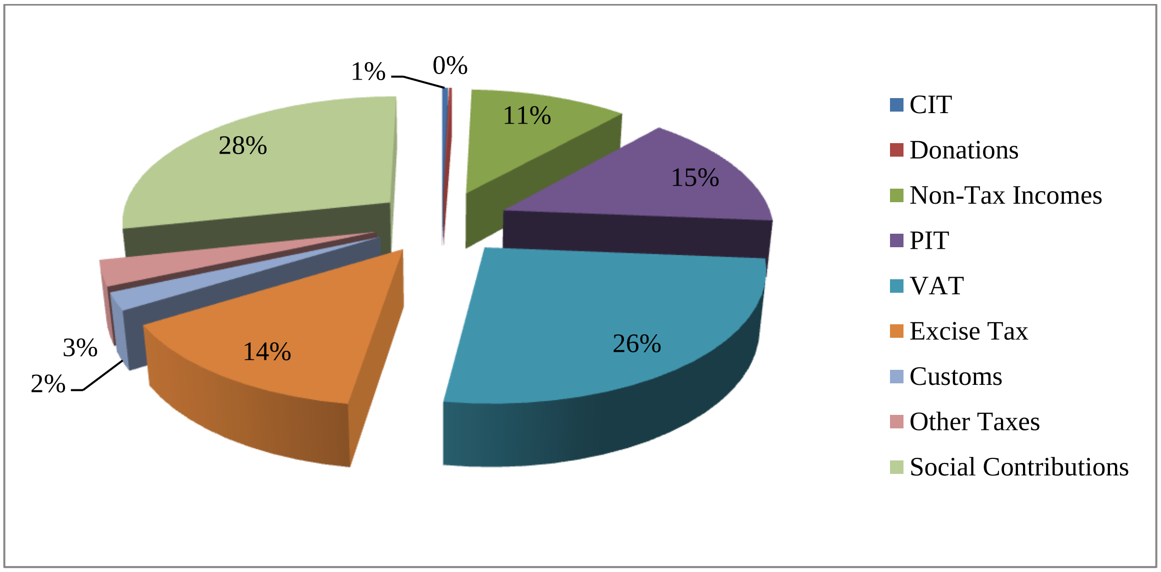
- Alcoholic beverages: fruit spirits, wines, special brandies and spirits of grain and other agricultural raw materials; spirits and liqueurs, low-alcohol beverages, beer,
- Coffee: raw, roasted, ground and coffee extracts.

Excise tax obligation arises in case excise products are manufactured in the Republic of Serbia, or imported into the country. According to the Serbian Excise Tax Law, the taxpayer of this type of taxes is a manufacturer or excise goods importer (Zakon o akcizama**).**

### 3.3 Tax Mix

The following chart represents consolidated public revenue for the year 2013 in the Republic of Serbia. As we can notice from the Chart 1, in 2013 social contributions had made 29% of the total public revenue, VAT 26%, PIT 15%, Excise Taxes 14%, non-tax incomes 11%, other taxes 3%, custom duty 2%, CIT 0.40%, and donations 0.20%.

**Chart 1**: Consolidated Public Revenues in Serbia (2013)




(Source: my own preparation based on information gathered from www.mfin.gov.rs)

In order to provide more accurate information in regards to the public sector revenues in the Republic of Serbia, I have prepared the Table 4 below. As the table suggests, we can notice that overall, public sector revenues in 2013 were higher than in 2012. The same applies for total tax revenues. If we take a closer look to PIT statistics, we can notice that in 2012, PIT revenues were higher than in 2013. When it comes to VAT, income revenues were higher in 2013 than in 2012. In 2013, Serbia made more revenue on excise taxes than it did in 2012. Revenue on custom duties marks a higher amount in 2012 than in 2013.

**Table 4**: Public Sector Revenues in Serbia in Billions of Dinars (2012-2013)

| | **2012** | **2013** |
|---|---|---|
| **Public Revenues** | 1.405,4 | 1.467,9 |
| **Tax Revenues** | 1.225,9 | 1.296,4 |
| **PIT** | 165,3 | 156,1 |
| **VAT** | 367,5 | 380,6 |
| **Excise Tax** | 181,1 | 204,8 |
| **Customs** | 35,8 | 32,5 |
| **Other Taxes** | 42,6 | 43,5 |
| **Contributions** | 378,9 | 418,3 |

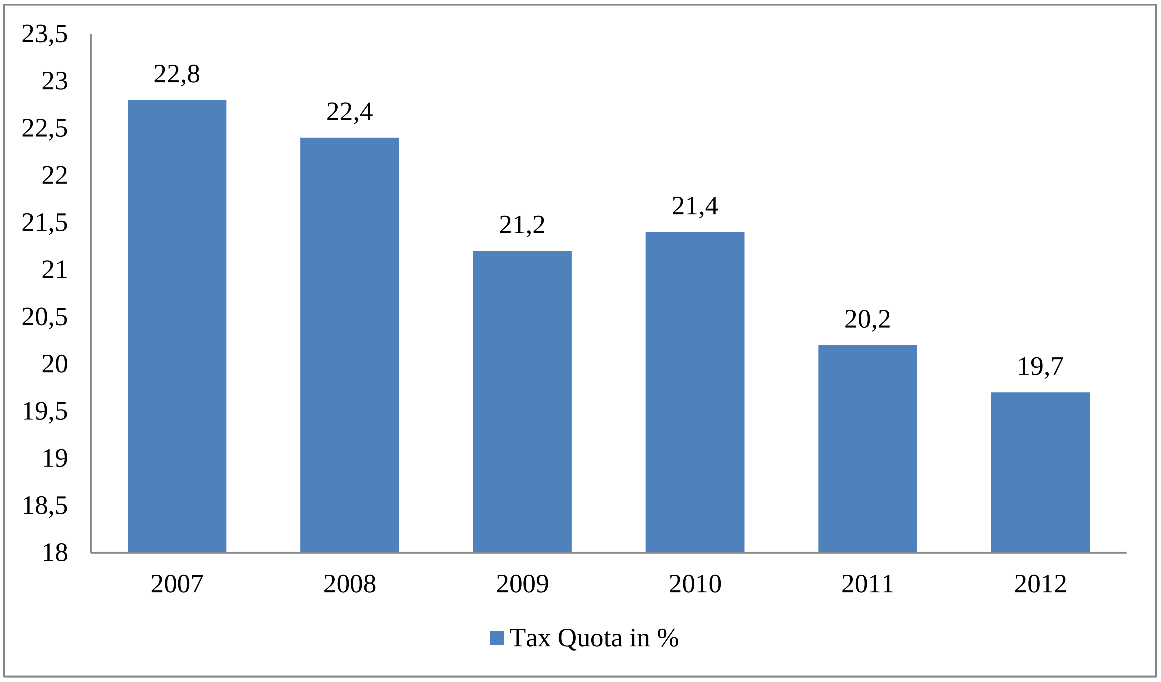
(Source: my own preparation based on information gathered from www.mfin.gov.rs)

## 3.4 Tax Quota

As we already know, the tax quota is a macroeconomic indicator which shows proportion of selected taxes to GDP.  The following Graph illustrated below presents simple tax quota development in the Republic of Serbia from the year 2007 until 2012. From the presented data, we can see that the tax quota in Serbia is rather gradually decreasing, with the exception of the year 2010, when it only slightly increased. As the Graph 12 suggests, in 2007 the tax quota in the Republic of Serbia was 22.8%. In the following year it decreased to 22.4%. The trend of decreasing continued in the year 2009 as well, when the tax quota dropped to 21.2%. Only in 2010 the tax quota increased, however very slightly, to 21.4%. The trend of decreasing continued further on even in the following year, 2011, when it dropped to 20.2% and to 19.7% in 2012.

In the Republic of Serbia in the time period from 2007 until 2012 we can notice a long-term declining trend in the tax quota, and even during the financial and economic crisis since 2008, it did not show a significant increase, but it was rather declining. For taxpayers and perhaps even potential investors this is a clearly positive indicator.

**Graph 12**: Tax Quota in the Republic of Serbia (2007-2012)




(Source: my own preparation from the information gathered from data. worldbank.org)

## 3.5 Tax Relief

In the Serbian tax system, there are also certain tax reliefs, tax exemptions and deductions. When it comes to *corporate income taxation*, non-profit organizations are exempted from CIT for the year that the exemption is applicable, in case the organization makes a surplus of income over expenditure to up to 400 000 Dinars (92 220 CZK). Also, companies which provide job trainings, professional rehabilitation and employment of disabled people are exempted from paying CIT. Additionally, in Serbia if a taxpayer invests more than 800 million Dinars (18 500 000 CZK) in fixed assets for the performance of core activities of a company, and in the period of the investment the taxpayer also employs at least 100 people, the taxpayer is exempted from

CIT for a period of ten years, in proportion to the investment. Moreover, a taxpayer who performs activities in an underdeveloped area is also exempted from CIT for a period of five years (Stakić, Jezdimirović, 160).

In case of *personal income taxation*, there are certain exemptions as well. These exemptions include incomes of war invalids, incomes from child support, reimbursement for helping financial dependents, benefits for unemployed, benefits from health insurance, in the case of death of an employee assistance to his or her family members, help due to consequences of natural disasters, scholarships and student loans, food fees for amateur sportsmen as well as pensions and rewards for students for achievements during trainings and competitions (Stakić, Jezdimirović, 146).

There are additional tax exemptions and tax deductions, where taxes are not paid on certain types of incomes. These incomes are incomes of employees on the basis of public transport reimbursement, to up to 3098 Dinars (706 CZK), wages for business trips on the territory of Serbia and abroad to up to 1859 Dinars (424 CZK), reimbursement for accommodation and transport fees on a business trip as well as solidarity supports during sickness for the purpose of medical rehabilitation or disability of an employee or member of their family to up to 30 975 Dinars (7067 CZK) (Stakić, Jezdimirović, 148).

Special tax exemptions also apply to profits earned for work in foreign diplomatic and consular missions or international organizations accredited in Serbia, and their staff and family members, if they are citizens or residents of the Republic, tax earnings of people with disabilities as well as pensions. Tax relief in Serbia also applies in the case of recruitment of new employees with disabilities. When it comes to *VAT*, in Serbia there is a VAT exemption applied in the case of export of goods and services to other countries (Stakić, Jezdimirović, 330).

# II. Practical Part

## 4 Comparison of the Tax System of the Czech Republic and the Republic of Serbia

In the practical part of my diploma thesis, I will focus on the comparison of the taxation system of the Czech Republic and the Republic of Serbia, in terms of Serbia's tax system harmonization with the European Union, as Serbia is one of the candidate countries for the EU accession. Since the Czech Republic is a European Union member state, and Serbia is an accession member candidate, I will focus on comparing the two systems in terms of Serbia's convergence and unification with the tax system of the Czech Republic, therefore the tax system of the European Union.

I find this comparison significantly important, since tax systems and tax policies represent one of the most important features of the national sovereignty of any country, and these two factors are integral parts of the overall economic policy which any states leads. Taxation is an instrument of economic regulation, which can be used to impact consumption, encourage savings, shape company's organizations, as well as to stimulate domestic and foreign investment activities and many more. However, in spite of tax harmonization policies of the EU, taxes are now firmly in the hands of the Member States, both in terms of assessment and collection and in terms of spending of the tax revenues. In a single EU market, EU Member States should move in the same or at least similar direction in regards to their tax policies.

During my comparison, I will use the data collected in the theoretical part of my thesis. Firstly, I will focus on the comparison of the Corporate Income Taxation. Afterwards, I will focus on the Personal Income Taxation, since in my opinion this type of taxation in Serbia needs to be further reformed in order to create a fairer PIT system in the country. Furthermore, I will focus on the comparison of the property and excise taxes. Additionally, I will compare the VAT taxation, which is a type of taxation that has undergone the biggest number of reforms in Serbia's taxation system in order to reach the level it has currently, and in order to harmonize with the EU taxation systems.

In the last part of the practical part of my thesis, I will focus on the comparison of tax mixes in both countries, since this is a very important indicator showing us which taxes are being imposed in the countries, the importance of certain tax types in regards to the revenue they accumulate into the state budget. Additionally, I will also compare the tax quota in both countries, since this is one of the important macroeconomic indicators used for international comparisons. Lastly, I will also compare certain tax reliefs and deductions in both countries. In the last part of my diploma thesis I will elaborate on the conclusions that I have made in regards to my overall research, as well as how did the EU membership affect the Czech Republic after its acquisition, and how could it possibly affect the Republic of Serbia.

## 4.1 Corporate Income Taxes

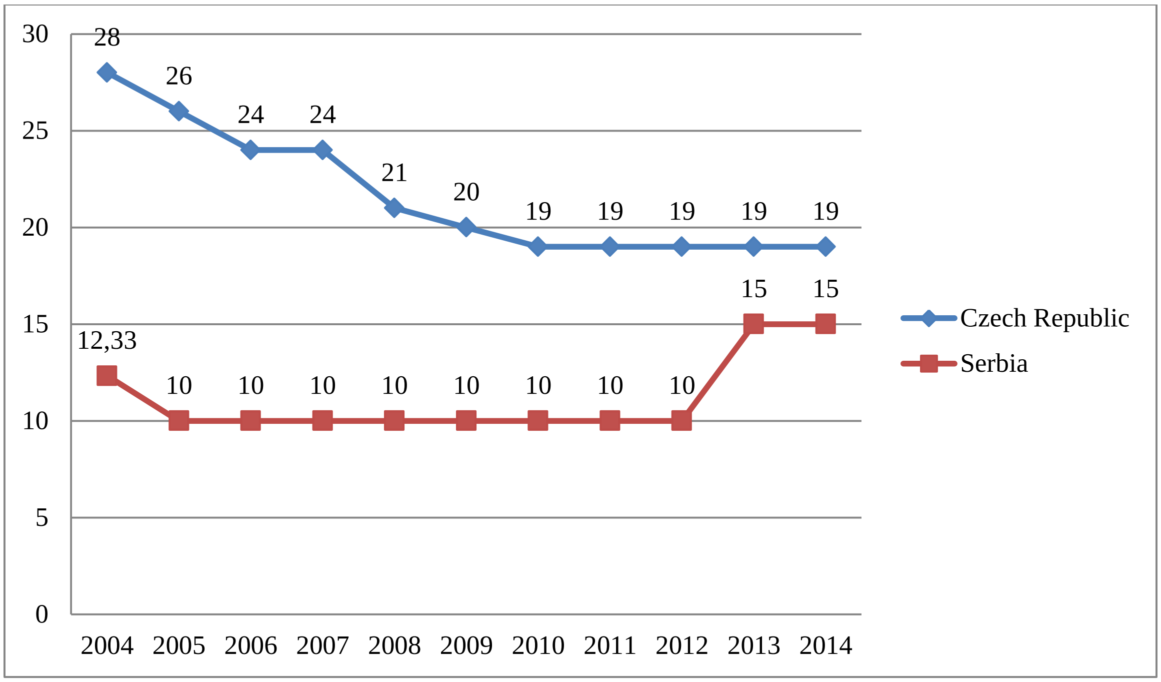
Even though CIT is a pretty young tax type in the modern taxation systems, it is a very important source of revenue for governments. In the case of Serbia, there have been certain reforms of the CIT throughout the 21$^{st}$ century. The goal of these reforms was to lower tax rates and expand tax incentives, as well as to influence the improvement of investment attractiveness of the country.

The reduction of the effective corporate tax rates to a certain level can have a positive impact on the inflow of foreign direct investment and economic growth. Certain changes have been made in the system of corporate taxation in Serbia which, while preserving the tax competitiveness of the country, made the system simpler, and tax expenditures smaller. The reforms of the income taxation in Serbia focused on the replacement of the existing heterogeneous and complex system of tax incentives and creation of a unique system of investment tax credits and rules for determining the tax base, as well as anti-evasion rules for taxation profits.

If we compare the overall structure of the corporate income taxation in the Czech Republic and the one that Serbia has today, we can notice that the countries have a very similar principle in regards to this type of taxation. When it comes to CIT, Serbia follows the OECD specifications. Serbia, as well as the Czech Republic, has a similar structure as well as the division of taxpayers and treatment of the resident and non-resident taxpayers of CIT.

However, what is not similar, are the CIT rates. As we can see from the graph below, the rates vary, and they are not the same throughout the analyzed time period. As the Graph 13 below suggests, throughout the entire mentioned time period, CIT rates are significantly lower in the Republic of Serbia. Therefore, all the forms which Serbia has implemented truly had an impact on making the CIT rates lower.

**Graph 13**: Corporate Income Tax Rate Comparison (2004-2014)




(Source: my own preparation based on information gathered from www.mfin.gov.rs and BusinessInfo.cz)

We can notice that in 2004, there had been the highest difference in the CIT rate in the two countries: the tax rate in Serbia was 12.33%, and in the Czech Republic it was 28%. While the CIT rate in Serbia remained constant from 2005 until 2010, at 10%, the rate in the Czech Republic has undergone many changes and it had dropped from 26% in 2004, to 19% in 2012. In the Czech Republic the rate of 19% had been constant from 2010 until the current year.

In Serbia, the CIT rate had raised in comparison to the previous years; in 2013 and 2014 it went up to 15%, which still is relatively lower in comparison to the Czech Republic's CIT rate of 2014 – 19%. According to the gathered data, we can notice that the CIT rate drastically dropped in the Czech Republic, meaning that the Czech Republic is significantly more attractive for investment today, than it was in 2004. Nonetheless, if we make an overall comparison, the gathered statistics imply that the Republic of Serbia is more attractive in terms of foreign investment, as well as from the perspective of legal (business) entities than the Czech Republic, which was the goal of the reforms which Serbia had made.

## 4.2 Personal Income Taxation

When it comes to PIT, the Republic of Serbia and the Czech Republic have different types of taxation. If we take into consideration that, according to Stakić and Jezdimirović, there are three types of personal income taxation: procedural, synthetic or global, and mixed tax system, where *procedural system* takes the position that any personal income, no matter on what grounds it was earned, should be taxed separately using the appropriate tax by proportional rates, *synthetic or global system*, which is based on the assumption that all personal incomes should be taxed by one comprehensive tax, with a progressive rate, regardless of the source of income, and *mixed system*, which basically is a procedural taxation with an addition of a complementary tax on gross personal income, which is paid at the end of the year in case total revenue exceeds the amount determined by the law (Stakić, Jezdimirović, 145), then we can conclude that the Czech Republic has a synthetic personal tax system, and the Republic of Serbia has a mixed personal tax system.

Personal income taxation has a special place in the tax systems of modern states, and the importance is seen not only because of the significance it has in regards to its public revenue contribution, but also because of possibilities to be used as a suitable instrument for achieving non-fiscal objectives of taxation. On the other hand, in Serbia, the role of PIT is somewhat different, however that does not mean that its current status will remain the same, since taxation reforms are a constant process, and therefore income taxation systems are constantly changing as well.

If we take into consideration all the previous research made in the theoretical part of my thesis in regards to the personal income taxation in Serbia and the Czech Republic, we can conclude that overall, the PIT system in the Czech Republic is fairer that the one in Serbia, thanks to its flat-rate PIT system, which theoretically takes an equal proportion of everyone's income since all taxpayers are being taxed at the same rate. The current personal income tax system in Serbia, on the other hand, compromises the principle of horizontal equity, as well as progressivity to a certain degree, thus, of vertical equity, having in mind that the income from various sources are taxed differently. Differentiated regimes of personal income taxation from different sources, and the application of various legal tax rates result in different effective PIT rates in Serbia, which definitely creates a certain amount of unfairness in the PIT system of Serbia.

As mentioned before, the Czech Republic has a flat PIT rate of 15%, which had remained constant for several years, and the Republic of Serbia has mixed tax rates in accordance to the type of income, as presented in the Table 5 below. We can notice that the country has three different tax rates: 10%, 15% and 20%. Such differences in personal income tax rates can significantly discourage taxpayers living on the territory of Serbia to engage in certain types of economic activities due to higher tax rates, which in fact is an unfair treatment towards some PIT taxpayers.

**Table 5**: PIT Rates in Serbia (2014)

| Type of Income | **Tax Rate** |
|---|---|
| **Earnings** | 10% |
| **Agriculture and Forestry** | 20% |
| **Self-Employment** | 10% |
| **Copyrights and Related Rights** | 20% |
| **Capital** | 15% |
| **Real Estates** | 20% |
| **Capital Gains** | 15% |
| **Other Incomes** | 20% |
| **Annual Income Tax** | 10/15% |

(Source: My own preparation according to the information gathered from http://www.poreskauprava.gov.rs).

Even though Serbia is one of the EU accession candidates, it still did not apply appropriate reforms of its PIT system. Based on the standpoint of Serbia's economic efficiency, possibly the most appropriate PIT system would be the proportional (flat-tax) system, therefore the one of the

Czech Republic. Equalization of tax rates would significantly simplify the PIT system in Serbia, and it would create space towards a fairer taxation system.

In Serbia, PIT from agriculture and forestry is a particularly sensitive topic. This type of taxation had not been imposed in the past; it is a matter of recent years. The main problems in regards to the taxation of individual agricultural activities and farmers with standard income taxes arise due to the following facts: they often do not know the complex tax regulations, and they generally do not do accounting or bookkeeping; there is a very large number of them in Serbia, with very often low incomes, therefore the tax administration usually does not have an interest to pursue costly control actions because of such small amounts; they often sell goods for cash, so the bookkeeping, even in case it would be enforced, would most probably be inaccurate. All these factors complicate any idea or attempt to tax farmers on their real incomes in Serbia. Therefore, in case an individual would make higher earnings from agriculture and forestry, the country would still not have an interest to track tax payments related to it, therefore this provides a huge space for tax evasion.

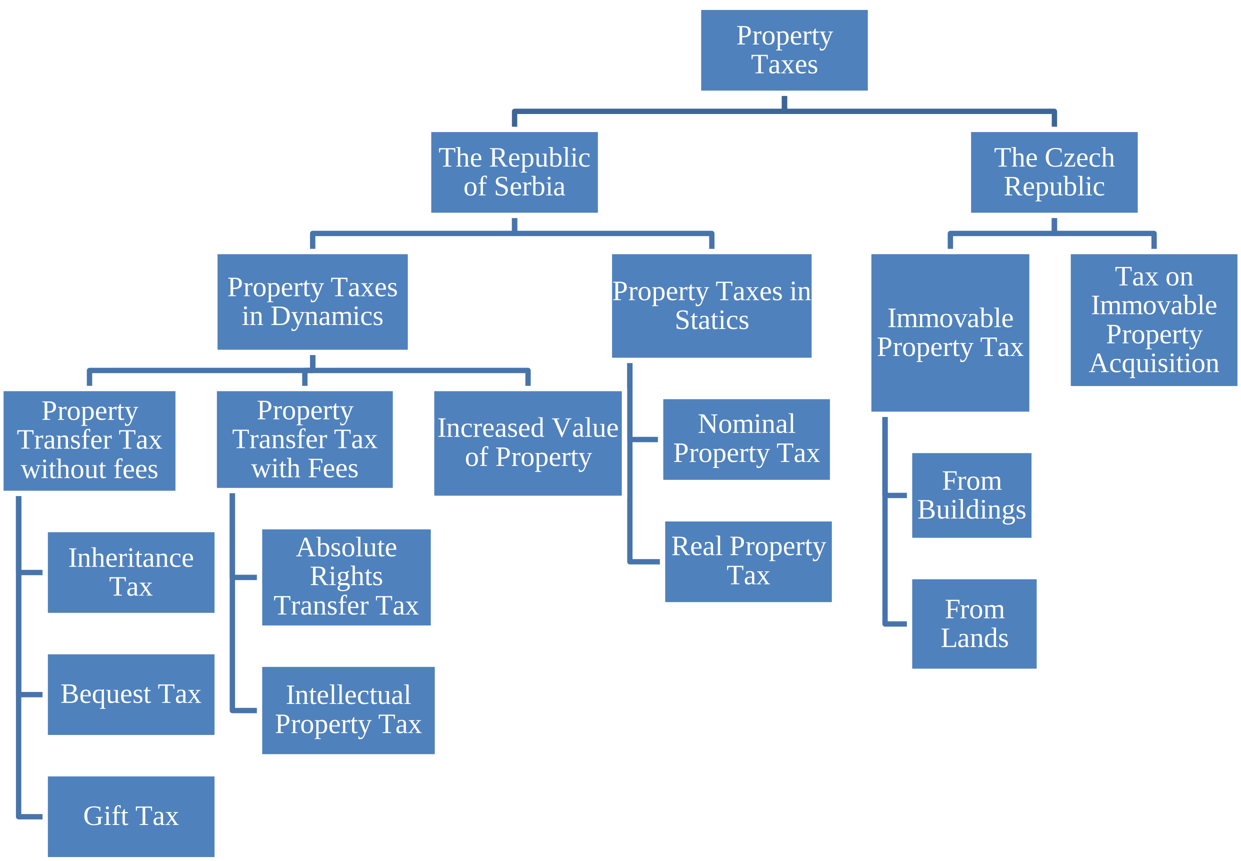
As already previously mentioned, mixed PIT system in Serbia does not provide vertical equity in taxation. In order to ensure a degree of vertical equity and collect additional tax revenues, Serbia introduced a corrective element in the form of the annual taxation of income at progressive tax rates, but given that it applies to only 1% of taxpayers, it does not make much sense to analyze it.

## 4.3 Property Taxes

Property taxes are another tax type which is different in both countries. The property tax structure in the Republic of Serbia differs from the one in the Czech Republic. As the following graph shows (Graph 14), the property tax structure in Serbia is much more complicated than the property tax structure in the Czech Republic. We can notice that the Czech Republic has a very simple property tax division, which is clear and simple structure. Serbia on the other hand has many subcategories which could perhaps be presented differently, and in a clearer manner.

Additionally, if we take a look at the tax mixes of the both countries (Chart 2 and 3 below), we can notice that according to the last years' data, the total tax revenue on properties in Serbia was lower (3%), than in the Czech Republic (8%). This probably is not a matter of lower tax rates as much as it is a consequence of the complicated property tax laws in Serbia, which provide bases for creation of illegal property purchasing and building, which due to the complicated tax laws is difficult to prevent. Many properties in Serbia had been built illegally, or on places which are not meant to be used for private properties.

**Graph 14**: Property Taxes in the Czech Republic and the Republic of Serbia




(Source: my own graph based on the information gathered from www.mfin.gov.rs - Zakoni and "Daňové zákony 2014").

Additionally, a certain amount of unfairness appears in the Serbian Property Tax Law regulations. In the tax legislation of the Republic of Serbia, revenue, income and assets are considered to be tax subjects. The property is unused or accumulated income that has already been subject to income taxation; therefore, when the income is transferred into the property, there is a double taxation - the property tax.

## 4.4 Excise Taxes

When it comes to excise taxes, the Republic of Serbia is following the regulations of the EU, which aim to create conditions for undisturbed functioning of the internal market harmonization of excise duties carried out on selected products, therefore the excise taxation in Serbia is very similar to the one of the Czech Republic. Possibly, the only matter which differs between the two countries is that in Serbia, is that coffee is a subject to excise taxation (Hrustić, 107-108), which in the Czech Republic is not the case.

Established general agreements on excise duties are made in order to ensure free trade of goods and not to increase the formalities related to their movement between the EU Member States. As mentioned before, excise duty is applicable to: mineral oils, alcohol and alcoholic beverages, and tobacco products, therefore harmonization within the EU is applicable on these particular goods (with the exception of coffee, as previously mentioned). These products may be subjected to taxation, according to the rules introduced by the EU directives on excise duties (Lopandić, 464).

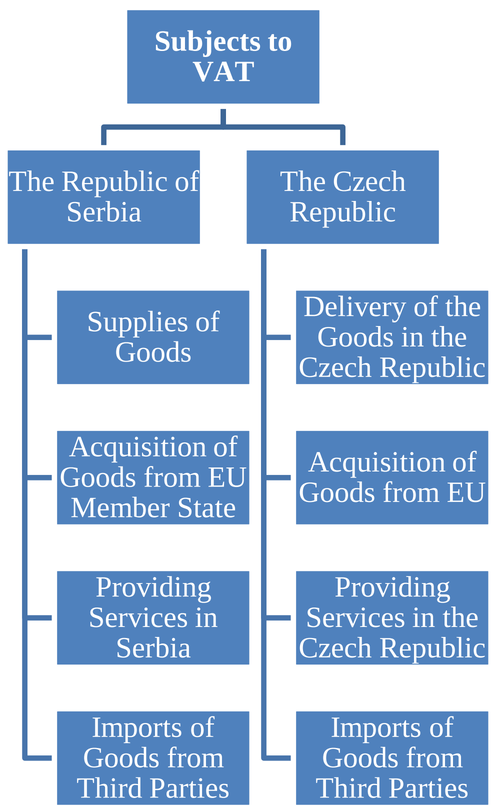
The Czech Republic follows these rules, as a member state of the European Union, and the Republic of Serbia has undergone many reforms in order to reach the harmonization with the EU Excise Duties regulations, thus the similarity in regards to this type of taxation between the two countries.

## 4.5 Value Added Tax

Value Added Tax is another fairly young tax type in comparison to other tax types, which has been around for about 50 years; nevertheless it is a tax type which became very popular with governments, since it is effective in terms of raising tax revenue, and not to mention the fact that it is paid by the final consumer which makes it a secure tax to collect, compared to conventional sales taxes which can be lost in case tax evasion occurs at the final sales stage. This tax type is attractive not only from the perspective of governments, but also from the taxpayers' perspective due to its transparent nature.

Currently, the Value Added Tax structure in the Republic of Serbia is similar to the one of the Czech Republic. Nonetheless, the VAT system in Serbia has not always been the same. It has gone through many reforms in order to get to its current structure. Serbia is mainly following the EU specifications in order to reach the Common EU VAT system harmonization, since its goal is to enter the EU, thus the similarity.

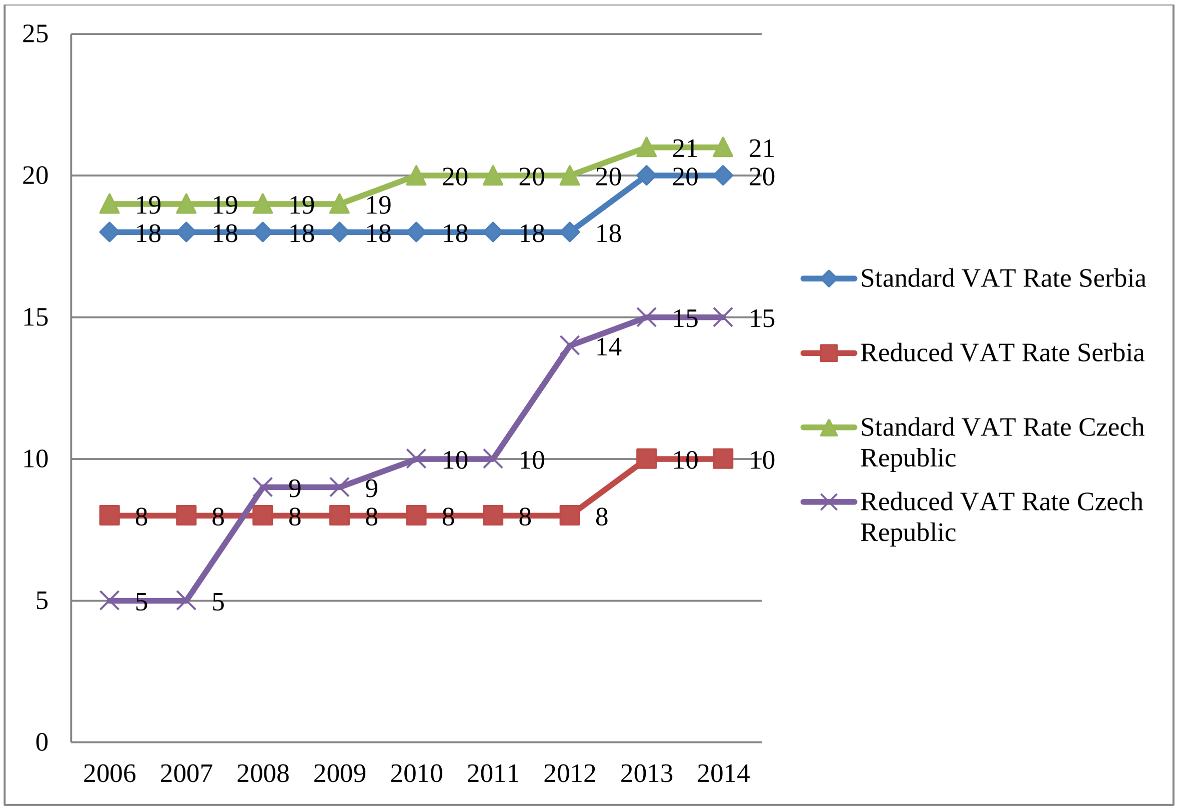
**Graph 15**: Subjects to VAT in the Republic of Serbia and the Czech Republic




(Source: my own graph made according to the information gathered from "Porez na dodatnu vrednost" and "Daňový systém ČR 2014").

As the Graph 15 presented above suggests, both countries target the same subjects in regards to the VAT taxation. These subjects are delivery or supplies of goods on the territory of the country, acquisition of goods within the EU, providing services on the territory of the country and imports of goods from countries which are not European Union member states, therefore third party countries.

**Graph 16**: VAT Rates in Serbia and the Czech Republic (2006-2014)




(Source: graph made on my own based on the information gathered from siepa.gov.rs and www.danarionline.cz)

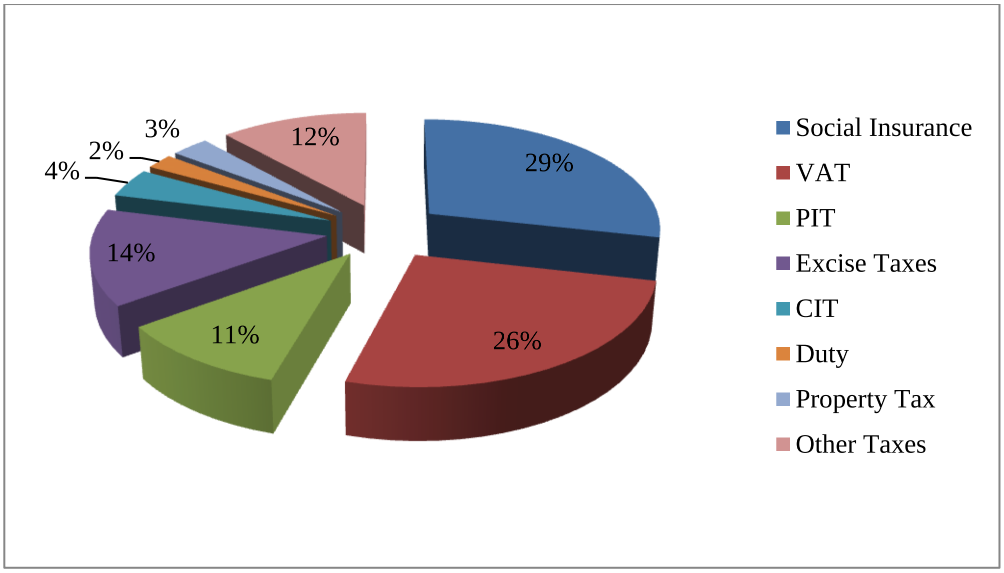
Additionally, if we take a look at the Graph 16, we can also notice that both countries have a standard VAT rate and each has only one reduced VAT rate. When it comes to the standard VAT rate, we can notice that in both countries rates are similar, nonetheless slightly higher in the Czech Republic (21%) than in Serbia (20%). When it comes to the reduced VAT rate, we can notice that the differences are much bigger. The current reduced VAT rate in Serbia (10%) is lower than in the Czech Republic (15%). If we take a look at the year 2006 (5%), the reduced

VAT rate in the Czech Republic is three times higher today (15%), than it was in the past. In Serbia, if we compare the data from 2006 until today, the reduced VAT rate rose by 2% in the current year. Therefore currently, the difference between the two countries in reduced VAT rate is 5%.

## 4.6 Tax Mix

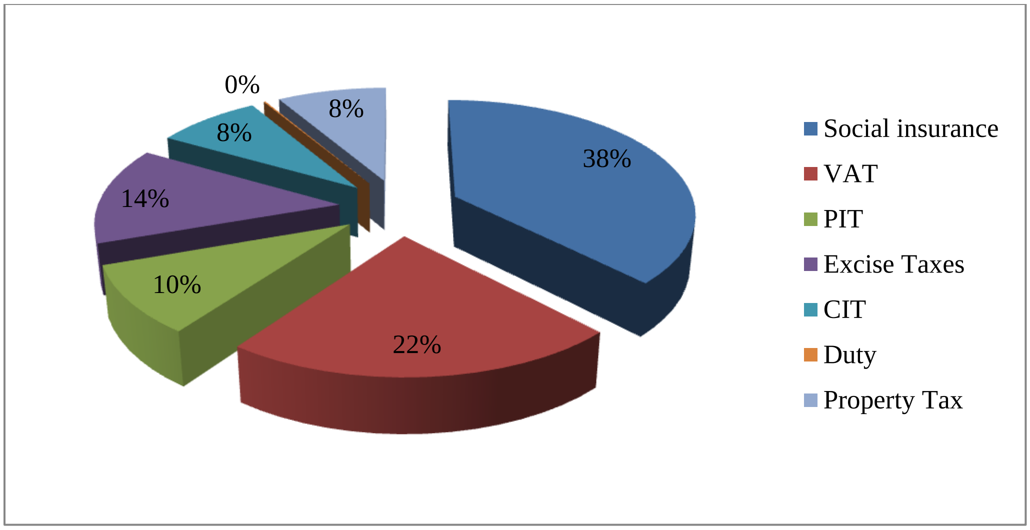
Another figure that I will use in order to compare the tax systems of the Czech Republic and the Republic of Serbia is tax mix. The tax mix is an indicator which indicates which tax is imposed, as well as its welfare effects, and the costs it imposes on consumers, workers and capital owners for a certain year in a particular country, in our case in 2013 in the Czech Republic and the Republic of Serbia.

**Chart 2**: Tax Mix in the Republic of Serbia (2013)




(Source: my own preparation based on information gathered from www.mfin.gov.rs)

**Chart 3**: Tax Mix in the Czech Republic (2013)




(Source: my own graph based on the information gathered from www.mfcr.cz)

Charts 2 and 3 presented above represent tax mixes in the mentioned countries. As the charts suggest, we can notice that the tax mixes in the two countries are similar. The highest share of tax representation for both countries belongs to the social insurance: 29% in the Republic of Serbia and 38% in the Czech Republic, therefore a bigger amount; in case of this type of tax revenue, it is an intended expenditure which is determined in advance. State Administration cannot use these funds differently than for the purpose for which they had been intended for, and from this perspective this is a specific tax type.

The second most important item is the VAT, or a general tax on consumption. This is a modern tax type, and its importance and revenue keeps growing. In Serbia the VAT makes a larger amount (26%) of the total tax revenue than it does in the Czech Republic (22%).

Other important items are the income taxes. Even though with a different structure, both countries divide income taxes into corporate income and personal income tax. When it comes to PIT, the data are approximately the same: PIT in the Republic of Serbia is 11%, and in the Czech Republic it is 10%. In the case of CIT, the data are different: in the Republic of Serbia it is 4%, while in the Czech Republic it is twice as much (8%).

Excise taxes perform a similar function as the VAT does; however they focus only on selected commodities. In a wide range of goods and services, excise taxes apply to only a few of them. The value of the excise tax revenue is exactly the same in both countries; even though this type of tax applies to just a few commodities, it makes 14% of the total state revenue. Therefore, its significance in regards to the tax revenue as well as the state budget is very important.

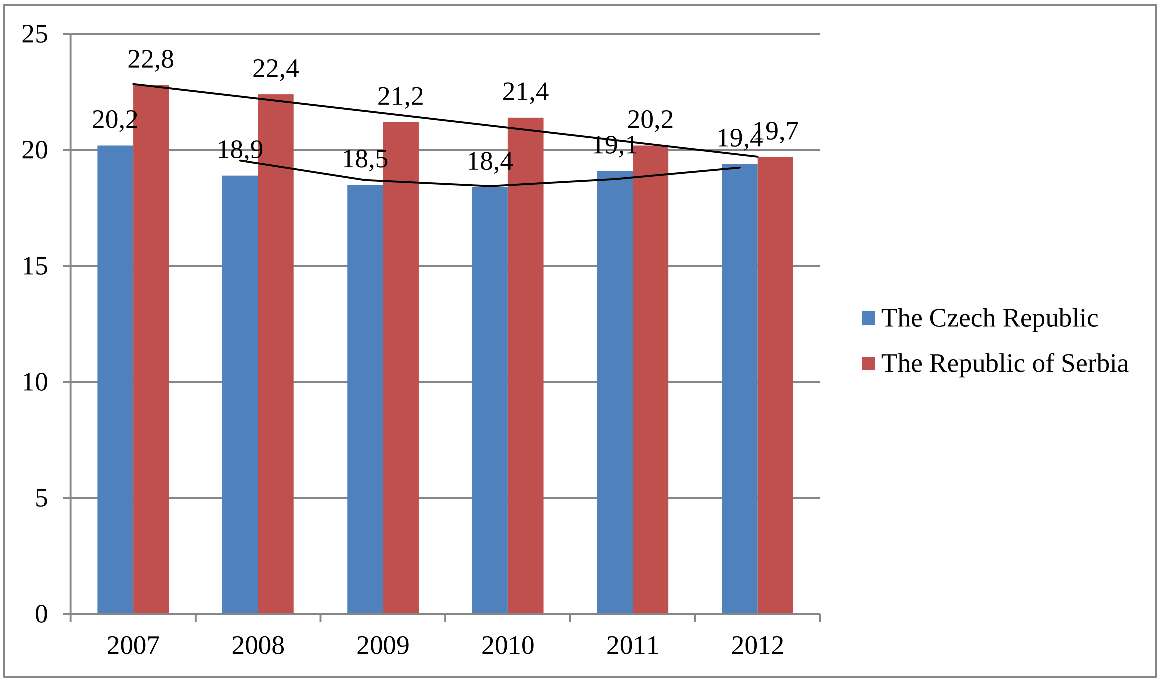
Another category consists of property taxes. Revenue from this type of tax is 3% in the Republic of Serbia and 8% in the Czech Republic. Overall, the total tax revenue of this type of tax is very significant, and its importance increases in regards to the fact that these are mostly revenues of municipalities or local government units. From this point of view, a few percent of the total tax revenue can be a significant amount. The last category is duty, which consists of relatively small amounts in both countries: 2% of the total tax revenue in the Republic of Serbia and an even smaller amount of 0.15% in the Czech Republic.

## 4.7 Tax Quota

As already mentioned before, tax quota is a macroeconomic indicator, and it is often used to compare the tax burden of the two or more states. In the case of compound tax quota, its percentage points represent the percentage of all collected taxes including social insurance to GDP each year. In the case of simple tax quota, its percentage points represent all the collected taxes without the social security contributions. In other words, the tax quota tells us what percentage of funds is paid to the state in the form of taxes from the total monetary value of goods and services which were created for the given period of time for the selected area, in our case in the Czech Republic and the Republic of Serbia in the time period between 2007 and 2012.

A visual comparison of the tax quota in the Czech Republic and the Republic of Serbia are presented in the Chart 4 below. The chart additionally illustrates different trends in individual countries.

**Chart 4**: Tax Quota Development in the Czech Republic and the Republic of Serbia (2007-2012)




(Source: my own preparation based on the data gathered from ec.europa.eu and data.worldbank.org)

From the data presented in the chart above, we can notice a lasting tax quota trend for the Republic of Serbia. The trend in the time period between 2007 and 2012 indicates a gradual downward linear drop in the tax quota, which accounts to 3.1 percentage points from 22.8% in 2007 to 19.7% in 2012. The highest tax quota was in 2007, when it reached 22.8%, and the lowest was in 2012, when it dropped to 19.7%.

In the Czech Republic, on the other hand, there is no apparent long-term trend in the tax quota. At the beginning of the analyzed time period, the tax quota began to drop, nonetheless in 2010 in began to increase. The highest tax quota during the mentioned time period in the Czech Republic was in 2007, when it reached 20.2%, and the lowest was in 2010, when it dropped to 18.44%.

Therefore, if we take into consideration the overall collected data in regards to the tax quota in both countries, we can notice that the overall tax burden as a percentage of GDP is more stable in the Republic of Serbia, and it seems that the long-term decreasing trend will continue, therefore in the upcoming years the tax quota might be even lower than it is now. In the Czech

Republic we cannot see a long-term trend in regards to the tax quota. The data show a perhaps more stable, and therefore generally more friendly tax burden in the Republic of Serbia, in the eyes of foreign investors for instance.

## 4.8 Tax Relief

As mentioned before, tax reliefs are a very important feature of any state's tax system, since they provide a kind of a tax discount or deduction to taxpayers, whether the taxpayer is a natural a legal person. These tax reliefs are present in the tax system of the Czech Republic, as well as the Republic of Serbia. In certain matters, these tax reliefs are similar or even the same in both countries; nonetheless in certain matters these reliefs differ.

When it comes to *corporate income taxation*, both countries provide tax reductions in the framework of investment incentives, and to companies which employ people with disabilities. Serbia additionally also has a tax relief for non-profit organizations and for companies which perform their economic activities in underdeveloped areas of the country.

Both countries also have tax reliefs in regards to the *personal income taxation*. They both have tax reliefs for people with disabilities, for students, and tax relief on dependents. Czech Republic in addition to this has a basic tax relief, which is a relief provided by the government in order to provide a minimum untaxed income for each taxpayer. Serbia, on the other hand, has a tax relief on incomes of war invalids, as well as solidarity support during sickness or medical rehabilitation as well as a financial assistance to family members in the case of death of an employee. When it comes to *VAT,* the Czech Republic has an exemption to VAT in case the taxpayer is able to provide an invoice directly from the payer of the VAT or a person registered for VAT in another EU country, and in Serbia, goods and services which are being exported to other countries are exempted from VAT.

# III. Evaluation of the Goals

The goal of my diploma thesis was firstly to introduce, and afterwards compare the taxation systems of the Republic of Serbia and the Czech Republic, in terms of Serbia's tax harmonization due to its accession into the EU as a candidate country in transition. Due to the fact that the two countries have different economic, socio-geographic, and historical differences, it is expected that the evolution of the tax systems would not take the same path. Thanks to many reforms that the Republic of Serbia has undergone, today we can say that the taxation systems of the two countries, in general, are similar in certain aspects, however also significantly different.

I have chosen to compare CIT, PIT, property taxes, excise taxes, VAT, tax mixes, tax quota and tax reliefs of the two countries. Throughout my research, I have found out that the PIT system, the PIT, CIT and reduced VAT rates, property taxes, tax quota and certain tax reliefs are different in the two countries.

According to the data that I have collected, I have found out that PIT is the tax type which most certainly has the most differences in the two countries. PIT system in the Republic of Serbia is mixed, while in the Czech Republic it is a flat-tax system. Due to its mixed nature, the PIT system in the Republic of Serbia creates unfair treatment and inequality. The PIT tax system in the Czech Republic, on the other hand, is a fair system of only one tax rate; Serbia should definitely closely consider a thorough reform of its PIT system, and should perhaps take an example from the Czech Republic's system, in order to reach a fairer personal income taxation pattern, which definitely would help in Serbia's process of the accession into the EU.

Additionally, I have concluded that the collected data showed differences in the tax quota in both countries for the analyzed time period (2007-2012). The data showed that in the Czech Republic, there is no particular pattern or a long-term trend, which implies a certain level of instability in the terms of tax burden in the country. The data of the Republic of Serbia showed a rather long-term decreasing trend, which implies that there is a generally more friendly tax burden in the Republic of Serbia.

Furthermore I have found out that there are certain differences in regards to tax reliefs in both countries. In the case of corporate income taxation, Serbia has an additional tax relief for non-profit organizations and for companies with the place of economic performance in underdeveloped areas, which is not present in the tax relief system of the Czech Republic. In the case of personal income taxation, the Czech Republic has a basic tax relief which lacks in the Serbian tax system, and Serbia on the other hand has a tax relief on incomes of war invalids, as well as solidarity support during sickness or medical rehabilitation, financial assistance to family members in the case of death of an employee, which, on the other hand, lacks in the Czech tax system. When it comes to VAT relief, both countries have a slightly different approach. In the case of the Czech Republic the taxpayers have the right to tax exemption in case they can provide an invoice from the payer of the VAT, and in the case of the Republic of Serbia, goods and services which are being exported to territories of other countries are being exempted from VAT.

Another tax type which is different in Serbia in comparison to the Czech Republic is the property tax. The property tax law in Serbia is very complex in comparison to the property tax law in the Czech Republic. The complicated system creates possibilities of tax evasion and does not allow the Serbian government to fully control and impose its property tax laws. Therefore, a reform is definitely necessary also when it comes to this type of taxation in Serbia. Czech property law, on the other hand, is very simple and more understandable.

Differences are for obvious reasons evident when it comes to tax rates. These differences were analyzed throughout the practical part of my thesis. Tax rates are developing and changing very fast and they are the easiest and fastest mean to respond to the overall needs of a country, or the current changes associated with the state budget. For all types of taxes, the figures were similar at one point; nonetheless tax rates show differences in recent time periods between the Republic of Serbia and the Czech Republic. I would especially emphasize the differences between the PIT rates, due to the fact the Republic of Serbia has a mixed PIT system consisting of three different tax rates (10%, 15% and 20%), and the Czech Republic has a flat-tax system with one PIT rate (15%).

CIT rates are different as well, even though the differences are not as huge as they were in the past (in 2005 for instance, the CIT rate in Serbia was 10% and in the Czech Republic 26%). The CIT tax rate was gradually decreasing in the Czech Republic, until 2010, where it remained constant until today, at 19%. The CIT rate in the Republic of Serbia decreased from 12.33% to 10% in 2005, where it remained constant until the year 2012; from 2013 the CIT rate increased due to taxation reforms that Serbia has undergone, and it rose from 10% to 15%.

Furthermore, I would like to also comment on the VAT rates. As mentioned before, the standard VAT rate in the two countries is similar. The standard VAT rate in Serbia was rather constant from 2006 until 2012, and in 2013 it rose by 2%, to 20% and it did not change even today. The standard VAT rate in the Czech Republic was constant from 2006 until 2010 at 19%, in 2011 it rose by 1%, to 20%, and in 2013 it rose again by an additional 1%, to 21%, where it remained until today's date. Therefore the standard VAT rate in the Czech Republic is higher by 1% in comparison to the Republic of Serbia, which is not a huge difference.

There are much bigger differences when it comes to the reduced VAT rates. The current VAT rate in the Republic of Serbia (10%) is much lower than in the Czech Republic (15%). One of the factors why this is so is definitely due to the lower livings standards in the Republic of Serbia, and the attempt of the government to make certain products more affordable to wider masses. The reduced VAT rate in the Czech Republic showed a higher increase throughout the time period between 2006 until 2014, where it rose from 5% in 2006 to 15% in the current year, which is three times higher. The reduced VAT rate in the Republic of Serbia did not show such a drastic increase: in comparison to 2006, when it was 8%, it rose to 10% in 2014, which makes a 2% difference.

Throughout my research, I have further found out that the CIT, excise taxes and VAT systems have a very similar pattern in both countries. This is mainly the case due to the fact that the Republic of Serbia tries to follow the taxation patterns of the EU in regards to this type of taxation.

Another indicator which I have analyzed in my diploma thesis is the tax mix in both countries. This indicator shows the importance of different types of taxes for the state budget, or better said it shows the amount of revenue contribution into the state budget. I have analyzed the data for the year 2013. The tax mix overall does not show any kind of drastic differences between the two countries when it comes to the type of taxes which are contributing to the state budget the most, nonetheless, there are differences in the percentage rates, therefore the amount of contribution. We can see that in the both countries, the biggest income to the state revenue is produced by the social insurance tax, where Czech Republic has a bigger share of 38% in comparison to the Republic of Serbia which has 29%. The second biggest share to the state budget in both countries belongs to VAT, where the figures show that in the Republic of Serbia, there is a higher contribution to the state budget by this type of tax (26%), than in the Czech Republic (22%).

## Conclusion

Any tax reform is very complex and specified by the internal limitations, external pressures of the great powers, particularly in the case of Serbia definitely also by wars, and the last 20 years by the international financial institutions. Fiscal development is a continuous process, which the bearers of fiscal policy implement over a longer period of time by adjusting the tax system of the country to various dynamic factors of economic, social or political nature. Yet, everything that was built for decades and centuries in developed market economies, were to be built in Serbia in only a few years, therefore there is no wonder that there are certain differences between the tax system of the Republic of Serbia and the Czech Republic.

Many countries of the European Union, as well as country candidates for EU membership started different tax reforms in order to achieve EU harmonization. This is what the Czech Republic needed to do as well in order to be accepted within the EU in May 2004, and it is also what the Republic of Serbia needs to do, for the same reason. Tax harmonization is also a very complex as well as a long-term process, due to all the reforms that a country needs to implement. Nonetheless, this is primarily due to the fact that each country has a different historical development of its tax system, which produces large differences in taxation in the EU Member States. Therefore, Member States are trying to cooperate in order to harmonize their tax systems to be able to remove or minimize the number of obstacles, in order to reach an improved functioning of the internal EU market.

Serbia has been going through tax reforms for years, and it is still changing its tax policies in order to reach the criteria which would be in accordance to the EU preferences. Nevertheless, there is no such thing as a perfect tax system, since each country has a different socio-economic and financial background as well as preferences and aspirations; however there is EU Tax Harmonization, which is a process that attempts to reach similarity in taxation systems in Europe. Naturally, it is impossible for each country to have an absolutely identical taxation system, because of the many disparities between various countries, starting from their histories to their current economic position. The Republic of Serbia and the Czech Republic had different historical backgrounds, and even today they have a different position within the global economy, however, they both are on the same territory - Europe, and they are very likely soon going to be in the same Union - the EU, not to mentioned that the both countries have similar goals in regards to the economic prosperity – to create a stable background in terms of financial efficiency.

The Czech Republic needed to undergo many reforms due to its accession into the EU, which took place in May 2004. Although the EU membership of the Czech Republic was a very desirable and a long-awaited state's goal, this naturally also raised certain concerns. Before the Czech Republic's accession into the EU, there were several forecasts and predictions of how EU membership would have a negative impact on the Czech economy. It was feared that there would be a huge inflation increase, liquidation of Czech companies, increase in unemployment, decline in industrial production, as well as a dramatic raise in the prices of food and an economic slowdown. It was also argued that the membership will be costly and a disproportionately large burden on the state budget. However, all of the above concerns proved to be rather unfounded (Marek, 1).

For the Czech Republic, the Membership meant full integration into a single EU market with a significant impact on foreign trade and investment. After May 2004, the foreign trade intensified and accelerated, which became the most important result of accession. Accession into the single EU market made trading with old as well as new EU members much easier. Simplification of custom rules, removing remaining tariff barriers, the cancellation of many border controls and harmonization of VAT rules encouraged cross-border activities and led to a significant trade increase. Additionally, the Czech Republic after its EU accession recorded continuous growth of direct foreign investments. EU Membership had a positive effect on the performance of the economy of the Czech Republic in key indicators such as GDP per capita, the level of wages, living standards and changes in consumption patterns. Nonetheless, the positive situation naturally began to change in 2008 in connection to the global financial crisis which began a year earlier in the US and subsequently began to affect other advanced economies. One of the main concerns in the pre-accession period was a sharp rise in domestic prices of goods and services after accession into the EU. This fact was, however, also influenced due to the geographic proximity of the Czech Republic to advanced and much more expensive EU Member States such as Germany and Austria. Nevertheless, pessimistic predictions about the dramatic increase in disposable food prices after joining the EU were not confirmed (Marek, 1-4).

In the case of Serbia's accession into the EU, it is difficult to make predictions, taken into consideration that in many cases the predictions and reality often differ. Nonetheless, it is a fact that in many matters, the accession of the Republic of Serbia into the EU would have a positive effect on the country's economy. For instance, due to the common EU market, there could be a better placement of resources, so that the standard of living in the country would increase. Additionally, accession of Serbia into the EU can bring the expansion of the choice of goods and services due to an easier access to foreign goods. Also, there would be a significant increase of volume of information, which could possibly lead to lower prices in certain economic spheres.

Accession of Serbia into the EU would also help the country make changes and reforms in its tax system, which would make its system more stable and definitely more appealing to foreign investors, which would help Serbia's overall economic health. It would also broaden the possibility of job opportunities and decrease unemployment due to the fact that Serbia's borders would be more open, and its economy would be more appealing to foreign companies, corporations, industries and even production.

The main objective of introducing a global tax rate and progressive tax system to transition countries was justified by the need to be closer to modern tax systems of developed countries. Serbia reached a certain level of harmonization with the EU when it comes to certain types of taxes, therefore the taxation system of Serbia today is much more similar to the one of the Czech Republic, than it was 5 years ago, for instance.

According to the overall collected data, we can come to a conclusion that Serbia, in comparison to the Czech Republic, does not really have a competitive market economy, and it is not as stable as the Czech Republic is when it comes to taxation system structure, nonetheless it is on the right way towards creating a better and a more stable tax system, thanks to the ongoing reforms and the process of tax harmonization.

Throughout my research, I have concluded that especially PIT system is significantly different in the two countries. Bearing in mind the obstacles of the implementation of progressive taxation, such as increasing tax evasion, capital outflows, complexity of administration of the PIT due to insufficiently modern tax administration, Serbia should definitely follow the example of the Czech Republic and implement a flat tax system.

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**Used Abbreviations**:

CIT: Corporate Income Taxes

CZK: Czech crowns

EU: European Union

GDP: Gross Domestic Product

IMF: International Monetary Fund

IMF: International Monetary Fund

OECD: Organization for Economic Cooperation and Development

OECD: Organization for Economic Cooperation and Development

PIT: Personal Income Taxes

VAT: Value Added Tax