NEWSLETTER 02/2019

The following topics are covered in this newsletter:

The Rulebooks are aimed at giving the full clarity to the recent changes of the Corporate Income and Personal Income Tax Laws that have introduced the tax institutes clarified and made applicable with above Rulebooks. Said Laws changes have been examined and summarized by us in one of the previous newsletters (no. 03/2018). If you want to have a look at that newsletter as well, please visit the following link.

1. New Rulebook on exercise of the right to double recognition of research and development (R&D) expenses in the tax balance

The new Rulebook has been published in the Official Gazette of the Republic of Serbia No. 50/2019 on 9 July 2019. This newsletter examines some of the key novelties that the Rulebook brings, such as:

- The Rulebook entered into force on 20 July 2019 and will be applied for determination of corporate income tax (CIT) liability for FY 2019.

- The Rulebook more closely defines the application of Article 22g of the CIT Law.

- The Rulebook specifies what can be considered as R&D expenses. Expenses that are *particularly* considered as R&D expenses and therefore eligible for double recognition are:
  - salaries of employees engaged in R&D activities;
  - materials directly associated with R&D activities;
  - right to use of intangible assets directly related to R&D activities;
  - acquisition and lease of real estates, facilities, equipment and intangible assets used directly for R&D activities;
  - obtained professional opinions and advisory services directly related to R&D (beside services acquired from related entities);
  - borrowings used for financing R&D activities, etc.

- Expenses that cannot be considered as R&D expenses are of the following:
  - marketing and advertising of a new product or service, resulted from R&D activities;
  - administrative and other general expenses that cannot be directly related to R&D activities;
  - employees' education and regular maintenance of fixed assets used or created as a result of the R&D activities.

- R&D expenses are tax deductible in the amounts recognized in the income statement, in accordance with accounting rules, and then are additionally included in the tax balance in the tax period when these expenses have been incurred.

- R&D expenses related to purchase or lease of real estate, facilities and equipment which, in accordance with the accounting rules, should not be treated as expenses, but rather as an asset (fixed asset), should be recognized as expenses in tax balance in the period when assets are acquired, or leased. The recognized amount should be either the amount of purchase price, or the total remuneration paid during the leasing period. Same applies for additional investments made in assets created as result of R&D, which are recognized as expenses in tax balance period when the investments are made. Furthermore, the above recognition rule does not affect recognition of amortization of all mentioned assets, i.e. their impairment.

- R&D expenses that are recognized as assets, have to be recognized in tax balance on pro rata basis, i.e. according to actual percentage of their utilization for R&D activities. This percentage should be determined in tax period when assets are acquired/leased. Consequently, taxpayer is liable to use this percent in duration of 10 (ten) tax periods for real estate and 5 (five) tax periods for other fixed assets. If taxpayer, prior to expiry of these periods, reduces determined percentage by more than 20%, than taxpayer is obliged to amend its taxable base for that period in the manner described in this Rulebook. In case of existing fixed assets used directly for R&D activities, expense is recognized as net tax value, proportional to utilization percentage. Consequently, this does not affect recognition of amortization for these assets.

- Taxpayer that uses R&D deduction is liable to submit, along with tax balance and for each project, documentation prescribed by the Rulebook. Documentation has to be submitted in a hard copy.

2. New Rulebook on exemption of qualified income from the CIT base

The new Rulebook was published in the Official Gazette of the Republic of Serbia No. 50/2019 dated 9 July 2019. This newsletter examines some of the key novelties that the Rulebook brings, such as:

- The Rulebook entered into force on 20 July 2019 and will be applied for determination of CIT liability for FY 2019.

- The Rulebook further clarifies the application of Article 25b of the CIT Law. It prescribes that the qualified

income generated by the taxpayer, on the basis of a deposited copyright or related rights ("copyright") or invention, may be excluded from the tax base in the amount of 80%, under certain conditions.

- The right to exclude qualified income from the tax base has a taxpayer who is a holder of deposited copyright and who generates an income on that basis. Taxpayer should deposit the copyright with the competent authorities or submit an application for the registration of the invention, no later than upon expiration of the tax period in which it first applies the CIT Law provision on exemption of qualified income from the CIT base.

Determination of Qualified Income

- Qualified income is determined for the tax period in the following way: the amount of total income generated from a deposited copyright or invention, should be decreased by the amount of qualified expenses and then multiplied by the percentage of the share of qualified expenses in the total expenses incurred in relation to that copyright or invention. Determined qualified income may be excluded from the CIT base in the amount of 80%.

Determination of Qualified Expenses

- Qualified expenses are consisted from the total historical or current tax-deductible expenses of R&D activities related to the creation of a deposited copyright or invention. Determination of expenses related to R&D activities should be done in accordance with the provisions of the R*ulebook on exercise of the right to double recognition of research and development expenses in the tax balance*, regardless whether the taxpayer applies this tax relief, or not.

- In case that a deposited copyright is acquired by status change (merger, demerger or spin-off) or in-kind contribution to the equity, the taxpayer takes into account the qualifying expenses of the transferor.

- The special rules of determination of qualified expenses apply for taxpayer who have deposited the copyright/submitted an application for the registration of the invention, after 1 January 2019, and those who, on 31 December 2018, had in its accounting records a fixed asset, asset in progress, intangible property or generated revenues from the copyright/invention. The amount of historical tax recognized expenses incurred before 1 January 2019 is determined according the following rules:
  - in the amount of 60% of income of the deposited copyright or the invention, in the first tax period in which this tax relief is used;
  - in the amount of 40% of income of the deposited copyright or the invention, in the second tax period in which this tax relief is used;
  - in the amount of 20% of income of the deposited copyright or the invention, in the first tax period in which this tax relief is used.

Determination of Total Expenses

- Total expenses are total qualified expenses increased by other expenses (such as, expenses related to R&D activities incurred against non-residents and a part of expenses from transactions with related parties exceeding the "arm's length" principle, etc.). If these expenses have not entirely been incurred for the deposited copyright/invention, but also for other purposes of the taxpayer's business activity, the expenses related to the copyright or the invention should be included in the total expenses on pro rata basis.

- In order for the qualified income to be excluded, taxpayer should have in place an appropriate documentation that should be prepared separately for each copyright/invention, in each tax period in which the exclusion was done. Documentation include confirmation from the authority that the copyright has been deposited, confirmation on submitted application for registration of the invention, records on income of generated on the basis of compensation for the exploitation of the deposited copyright/invention, record of the total R&D costs related to the creation of the deposited copyright/invention, etc.

3. New Rulebook on exercise of the right to tax credit based on investment in a newly established company that performs innovative business activity

The new Rulebook has been published in the Official Gazette of the Republic of Serbia No. 50/2019 dated 9 July 2019. This newsletter examines some of the key novelties that the Rulebook brings, such as:

- The Rulebook entered into force on 20 July 2019 and will be applied for determination of CIT liability for FY 2019.

- In accordance with the CIT Law, a taxpayer that invests in the share capital of a newly established company that performs innovative business activity ("the newly established company") will be entitled to use a tax credit in the amount of 30% of the investment made, but under certain conditions which are set out in this Rulebook. The taxpayer is vested the right to use a tax credit 3 (three) years after the investment, but under the condition that it did not reduce its investment in a newly established company in such period.

- In order to exercise its right, a taxpayer should submit the following documentation, along with the CIT return for the year of the investment:
  - UID form – *The statement on investment in innovative business activity;* and
  - UID 1 form – *The statement on fulfilment of conditions by a newly established company that performs innovative business activity.*

- By submitting the UID form, a taxpayer confirms that the following conditions are met for obtaining a tax credit:
  - that the investment was made in a newly established company that performs innovative business activity;
  - that before the investment, a taxpayer, independently or with all related parties, did not own more than 25% shares, i.e. voting rights in a newly established company; and
  - that investment was carried out by paying in share capital of a newly established company (as opposed to merely subscribing for share capital).

- By submitting the UID 1 form (that has to be signed and stamped by the legal representative of the company in which investment was made), a taxpayer confirms that a newly established company complies with the conditions prescribed by the CIT Law. These conditions are related to the amount of annual revenue of a newly established company, center of business activity, dividend distribution etc.

- After all conditions for obtaining tax credit are met, a taxpayer should submit UID 2 form – *The statement on fulfilment of conditions by a newly established company that performs innovative business activity* (that has to be signed and stamped by the legal representative of the company in which investment was made). By this form it is confirmed that a newly established company complies with the conditions related to level of R&D expenses, structure of employees and ownership over deposited copyrights.

- Final amount of tax credit available for the reduction of the CIT liability is determined in the PK 5 form – *Tax credit for investment in the share capital of newly established company that performs innovative business activity for period from ___ to ___ 20__.*

- All abovementioned forms should be submitted electronically.

4. New Rulebook on exercise of the right to tax exemption with respect to organizing recreational, sport and similar activities for the employees

The new Rulebook has been published in the Official Gazette of the Republic of Serbia No. 50/2019 dated 9 July 2019. This newsletter examines some of the key novelties that the Rulebook brings, such as:

- The Rulebook entered into force on 20 July 2019.

- Tax exemption from salary tax is envisaged for the expenses incurred for:
  - recreation of employees at work premises; and,
  - reimbursement of costs for collective recreation and for organizing sport and other activities for the employees in order to improve their health and/or create a stronger relationship among employees.

- The tax exemption from aforementioned benefits can be only utilized if such benefits are:
  - properly documented;
  - the employer has made the payment directly to the suppliers;
  - defined with the general act of the employer; and,
  - all employees are entitled to the benefits of the same type, volume and quality, as determined in the general act of the employer.

- The Rulebook defines more precisely the costs of recreation of employees at work premises (construction/ adaptation of premises and/or purchase of recreational equipment, etc.) and what is considered under compensation of collective recreation costs (lease of sport facilities, use of gym, outdoor / indoor swimming pools, etc.). Additionally, the Rulebook defines the method of tax exemption in case when specific circumstances exist with the employer, *inter alia*, a large number of employees, physical division of the organizational units, etc.

- If the employer has individuals who require specific type, quality and volume of the recreational need, tax exemption would only be granted if this requirement is documented with appropriate medical reports.

- In case of organization of sports and other activities that are organized to improve health and/or to create a stronger relationship among employees, and between employees and employer, the Rulebook envisaged that tax exemption could be granted only in case when the right to participate has at least 70% of total number of employees and if at least 70% of employees use this right.

5. New Rulebook on exercise of the right to tax exemption for employees on the grounds of shares received without compensation or on preferential terms

The new Rulebook has been published in the Official Gazette of the Republic of Serbia No. 50/2019 dated 9 July 2019. This newsletter examines some of the key novelties that the Rulebook brings, such as:

- The Rulebook entered into force on 20 July 2019 and regulates the conditions under which a tax exemption can be used in respect of the employee's income on the basis of own shares, share options in equity of a related party, received without compensation or on preferential terms, from the employer or the employer's related party.

- In order for the employee to use right to tax exemption for received own shares, the following conditions should be met:
  - the basis, methods and conditions for acquiring own shares from an employer or employer's related party should be regulated by a general act, employment contract or other legal act of the employer

or the employer's related party;

- full clarity has to exist regarding acquisition date, qualitative and quantitative elements of the acquired shares, such as type, number, percentage, etc;
- that the employee has not alienated acquired shares before the expiration of 2 (two) years from the day of their acquisition. The sufficient evidence is the statement of the employee given under criminal and material responsibility and the corresponding document from the electronic database of the Central Securities Depository;
- that the employer or employer's related party has not redeemed its own shares from the employee, which is proved by the statement of the legal representative of the employer or the employer's related party, given under criminal and material responsibility;
- that the employment relationship was not terminated before the expiration of two years from the day of acquiring the right to dispose of companies' own shares. The compliance with this condition is proved by the employment agreement and the particular document obtained from the Central Registry of Compulsory Social Insurance.

The above mentioned documentation should be collected on the day of expiration of the second year from the date of acquiring the right to dispose of companies' own shares, by a person/entity who is, in accordance with the Personal Income Tax Law, obliged to calculate, report and pay the salary tax.

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Kind regards

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