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Svetislav V. Kostić, PhD*

TRANSFER PRICING IN SERBIA – FACING A SOBERING REALITY

This paper attempts to systematize the basic pillars of Serbian policy in the area of corporate income taxation of related party transactions (transfer pricing). The author looks at the very first Serbian transfer pricing legislation introduced in 1991 and follows its development through to the present. Principle focus is directed towards the policy drivers behind the 2012 and 2013 comprehensive reform of the Serbian transfer pricing provisions, which the author analyses with the added value of hindsight. Despite a generally positive view on what was achieved by the 2012 amendments to the Serbian transfer pricing legislation, the author offers a divergent view. A critical assessment is provided and the author stipulates the reasons which suggest that the respective amendments failed to meet desired goals in the area of transfer pricing set in 2012 and 2013. The author tries to deduce the lessons that should be taken into consideration in the future legislation reform initiatives and attempts to find alternative paths that should be taken in order to avoid repeating identical mistakes.

Key words: *Transfer pricing. – Amendments. – Safe harbor. – OECD.*

1. INTRODUCTION

Although transfer pricing may seem only a complex and rather technical area of tax law, in Serbia (and perhaps not only in Serbia) the story of the development of provisions dealing with the tax treatment of related party transactions (i.e. transfer pricing) may provide us with some sobering lessons that could easily be applied in various other fields of legislation. The primary focus of our further deliberations will be the deduction of what were the principles driving Serbian policy makers when tailoring transfer pricing legislation and the assessment of whether they

* Assistant Professor, University of Belgrade Faculty of Law, skostic@ius.bg.ac.rs.

were able to accomplish their desired goals. The story of transfer pricing in Serbia will bring us face to face with the rather worrying state of the Serbian policy and administrative infrastructure and the need to consider this factor when contemplating future normative development. It will also show the level of self-imposed isolation that the Serbian policy makers and government administration are content to dwell in. While we will attempt to determine the reasons for the failure of Serbian policy makers to bring Serbia, within the ambit of transfer pricing, in line with at least its neighbors, an attempt will also be made to propose alternatives to the approach that has been tried many times and is evidently unsuccessful.

2. THE BASIC PRINCIPLES OF SERBIAN TRANSFER PRICING LEGISLATION AND THE ORIGINS OF THE TRANSFER PRICING CONTROVERSY

Serbia introduced specific transfer pricing legislation as early as in 1991¹ and in its design it adopted the arm's length principle, which is stipulated in Art. 9(1) of the OECD Model Tax Convention on Income and on Capital:²

“Where

- a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
- b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.” Furthermore, Serbia relied on the initial work done under the auspices of the OECD in developing the methodology for the implementation of the arm's length principle.³

¹ See: Articles 53–56 of the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia*, No. 76/91.

² The OECD's definition of the arm's length principle has remained unaltered since its introduction in the 1963 OECD Draft Double Taxation Convention on Income and on Capital.

³ Report of the OECD Committee on Fiscal Affairs on Transfer Pricing and Multinational Enterprises (OECD 1979), International Organizations' Documentation IBFD;

However it was not until the end of the first decade of the 21st century that the topic of the treatment of related party transactions received much attention from the Serbian tax profession in general.⁴ While the turmoil of the 1990s can be relied upon to explain the *dormancy* in the application of the Serbian transfer pricing norms at the time, during the beginning of the 21st century an excuse can be found in the view that the Serbian Ministry of Finance and the newly created Serbian Tax Administration (established in 2002) had more pressing issues to address.

To understand the potential relevance of transfer pricing rules we must revert to the principles of Serbian policy in the area of corporate income taxation. Namely, in an attempt to attract as much foreign investment as possible Serbian tax legislation provided one of the lowest corporate income tax rates in Europe.⁵ The vast majority of the foreign investments that have entered the country were sourced from multinational enterprises, while complex domestic business structures also developed and expanded. Thus, as in other parts of the world, Serbia witnessed an ever increasing volume of related party transactions. Whole sectors of the Serbian economy quickly became an integral part of the globalized market and rely heavily on their foreign or domestic affiliates for their day-to-day operations (e.g. the financial sector, telecommunications, energy sector, automotive manufacturing, food processing, etc.).

As related party transactions are a crucial part of the Serbian economy, which is also heavily dependent on foreign investments, one cannot overemphasize the importance of their tax treatment. Two main potential adverse consequences may arise from the improper application of transfer pricing legislation. If transfer pricing rules are not applied and audited with diligence taxpayers may be tempted to shift profits between related parties in a way that would allow them to lower their overall tax obligations (tax obligations at the level of the group). Therefore, proper application of transfer pricing norms is important in order to protect government fiscal revenues. However, improper application in the form of an overly aggressive posture by the tax administration when applying transfer pricing provisions may lead to equally worrying consequences. Namely, if one of the key incentives for attracting foreign investment is a low corpo-

Transfer Pricing and Multinational Enterprises, Three Taxation Issues, OECD, Paris 1984.

⁴ For an overview of the legislative development of Serbian transfer pricing provisions from 1991 until 2010 see: S. Kostić, “The New Serbian Transfer Pricing Rules”, *Tax Notes International* 4(71)/2013, 345–347.

⁵ From 2004 until 2012 the corporate income tax rate in Serbia was 10%, while as of 2013 it was increased to a still comparatively quite modest 15%. For example, in 2013 the average corporate income tax rate in the European Union stood at 24,5%. See: S. Randelović, “Osvrt 2. Analiza parametarske reforme poreza na dobit preduzeća u Srbiji”, *Kvartalni monitor* 31/2013, 62.

rate income tax rate, applying tax legislation in a way that can easily make this incentive irrelevant⁶ will quickly lead potential investors to either seek informal protection from the tax authorities (thus contributing to the already existing problem of government corruption) or to find alternative destinations for their capital. With respect to Serbia, the facts that the country is relatively small, does not possess significant natural resources, and is surrounded by jurisdictions offering similar incentives and opportunities to investors, all further contribute to the need not to send wrong signals to the global market.

Although rumors regarding a potentially significant transfer pricing case were present a lot earlier, it was on 24 December 2010 that the Serbian tax community was publicly confronted with a new reality. A CFO of a company that is a part of a notable multinational group (Carlsberg) had criminal charges for tax evasion brought against him by the Serbian Tax Administration, wherein one of the reasons for such an action was the alleged underpayment of corporate income tax by virtue of applying presumably lower than market prices in related party transactions.⁷

The Carlsberg case had tremendous impact on the way in which the issue of transfer pricing was viewed in Serbia. It showed that the Serbian Tax Administration was prepared to confront a major foreign investor (or to be more precise its Serbian subsidiary) on the tax treatment of transactions that take place within a multinational enterprise. Furthermore, it testified to a highly aggressive posture of the Serbian Tax Administration, which not only brought criminal charges against the taxpayer's CFO, but also made its accusations public.⁸ On the other hand, unofficial information regarding the case implied that the Serbian Tax Administration gave no credibility to the internationally accepted methodology of dealing with transfer pricing, based on the 1995 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, well-established at the time, and even more importantly completely disregarded the documentation, provided by the taxpayer, which was widely accepted for identical purposes in numerous other tax jurisdictions.

What was even more worrying was the fact that at the time, apart from very scarce provisions of the Serbian Corporate Income Tax Law⁹

⁶ See: G. Ilić-Popov, S. Kostić, "Transferne cene u Srbiji", *Industrija* 4/2011, 178.

⁷ Finansijski direktor "Carlsberg Srbija" osumnjičen za utaju, <http://www.blic.rs/vesti/hronika/finansijiski-direktor-carlsberg-srbija-osumnjicen-za-utaju/fkq020n>, last visited 2 October 2017.

⁸ While the public announcement of bringing criminal charges against a taxpayer raises issues of both tax secrecy and intentional taxpayer defamation, the scope of this article does not allow us to discuss these important issues.

⁹ Articles 59–61 of the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia*, No. 25/01, 80/02, 80/02, 43/03, 84/04, 18/10.

and corresponding regulations,¹⁰ no other sources dealing with the issue of transfer pricing were available in Serbian language. Taking into account the level of foreign language proficiency within the Serbian Tax Administration and the lack of information regarding any comprehensive training or preparation for the purposes of auditing related party transactions by its inspectors, the Serbian tax community was concerned with the actual capability of the Serbian Tax Administration to properly apply the respective legislation. Such concerns were further exacerbated by the fact that the foreign investors community in Serbia has, to no avail, since 2007 publicly warned on the poor quality of the Serbian transfer pricing legislation:

“Provisions governing transfer-pricing are too vague and are rarely implemented in practice. The lack of legislative guidance and any reliable practice in this area have caused significant uncertainties as to the way taxpayers should handle their related-party transactions.”¹¹

In essence, Serbian taxpayers were faced with a tax authority that was evidently ready to immediately levy a heavy hand in applying insufficiently clear legal provisions, in whose application it had virtually no prior experience or training, and where it had no Serbian language professional literature to rely on for further guidance.

The issuing of the new Rulebook on the Contents of the Tax Balance Sheet and Other Issues Relevant for the Determination of the Corporate Income Tax (hereinafter: the Rulebook) on 21 December 2010¹² only contributed to the aforementioned concerns, as its provisions relating to the definition of what is to be deemed an arm’s length interest rate, for the purposes of testing related party loans,¹³ showed that not only the Serbian Tax Administration, but the Ministry of Finance in general did not have a sound grasp of the basic principles of transfer pricing. The problem was of such magnitude that the Rulebook had to be amended in this respect already on 8 February 2011.¹⁴ While the newly introduced amendments

¹⁰ Article 5 of the Rulebook on the Tax Balance Sheet of Corporate Income Taxpayers, *Official Gazette of the Republic of Serbia*, No 139/04.

¹¹ *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2007, 37; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2008, 53; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2009, 72; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2010, 95.

¹² The Rulebook on the Contents of the Tax Balance Sheet and Other Issues Relevant for the Determination of the Corporate Income Tax, *Official Gazette of the Republic of Serbia*, No. 99/10.

¹³ Article 5(7) of the Rulebook.

¹⁴ Article 2 of the Rulebook on the Contents of the Tax Balance Sheet and Other Issues Relevant for the Determination of the Corporate Income Tax, *Official Gazette of*

pacified the main vested interests that lobbied for them (primarily the financial sector, i.e. banks), even the improved provision warranted a harsh, but in our opinion fair, assessment from the foreign investor community:

“By-laws for determining arm’s length interest rate on loans between related parties are not in accordance with the provisions of CIT Law and best international practice, and should be abolished.”¹⁵¹⁶

With all the problems with respect to transfer pricing becoming so evident within the space of a single year, the Serbian Government voted into office in the late spring of 2012 had its task set out.¹⁷

3. THE POLICY BEHIND THE 2012 AMENDMENTS TO THE SERBIAN TRANSFER PRICING LEGISLATION

The Working Group for Amending the Corporate Income Tax Law (hereinafter: Working Group), which was formed in the summer of 2012 by the Ministry of Finance, received a broad mandate, with the improvement of the Serbian transfer pricing normative framework being at the top of its agenda. In this paper we will not address the finer points of the changes introduced into this area of tax legislation in late 2012, but will focus more on the goals that the Working Group and the Serbian Government wanted to achieve.

The basic idea behind the 2012 Serbian transfer pricing amendments was to simultaneously:

- 1) defend Serbia’s public revenues,
- 2) ensure durable legal certainty in the area of transfer pricing and send a strong message to the international business community that Serbia is a safe place to invest (“wash away the Carlsberg case sin”), and
- 3) assist the creation of the administrative capacity necessary for achieving the previous two goals.

Already in the autumn of 2011 the Serbian Fiscal Society, an association of tax professionals and the Serbian national branch of the International Fiscal Association, translated the 2010 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (here-

the Republic of Serbia, No. 8/11.

¹⁵ *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2011, 112.

¹⁶ Cf. G. Ilić-Popov, S. Kostić, 160.

¹⁷ 2012 Serbian parliamentary elections were held on 6 May.

inafter the OECD Transfer Pricing Guidelines) into Serbian language¹⁸ and, in an attempt to assist them in capacity development, donated a considerable number of copies to the Serbian Tax Administration and the Ministry of Finance. In some countries it was the translation of the OECD Transfer Pricing Guidelines into the official language and the reliance on them by the tax authorities that drove the development of the domestic transfer pricing practice.¹⁹ However, in Serbia it became evident that the Serbian Tax Administration would not take any independent action unless provided with an explicit legislative instruction to do so. Therefore, the Working Group took on the task of preparing detailed amendments that would allow for as much clarity as possible in an inherently vague area of tax law and bring Serbian tax legislation in line with the best current comparative practices. The actual depth of the 2012 amendments can be described with some ease by virtue of a simple word count comparison. Transfer pricing norms within the Corporate Income Tax Law increased from a total of 335 words (2088 characters with spaces) to 1116 words (7140 characters with spaces). While the legislative text almost quadrupled, the body of the transfer pricing regulations increased more than ten-fold (from 347 words to 3553 words dedicated to transfer pricing).

With respect to the role of the OECD Transfer Pricing Guidelines, the Working Group decided to be cautious. Namely, despite strong voices advocating that they be made part of the Serbian tax legislation,²⁰ or to at least make them binding for the Serbian Tax Administration only,²¹ it was decided not to give the OECD Transfer Pricing Guidelines official status under Serbian law, but to allow them to have some form of a soft-law role.²² Such a policy decision was supported by the following arguments:

- 1) The OECD Transfer Pricing Guidelines are not meant to be a statutory document – they provide thoughts and dilemmas, alternative approaches to solving problems and sometimes will not take a firm position on an issue. In other words, they are

¹⁸ *Smernice OECD za primenu pravila o transfernim cenama za multinacionalna preduzeća i poreske uprave*, Srpsko fiskalno društvo – OECD, Beograd 2011.

¹⁹ E.g. Croatia. See: N. Tucaković, M. Vergles, “Nadzor transfernih cijena”, *Porezni vijesnik* 7/2008.

²⁰ E.g. Slovakia from 1 January 1997 until 31 December 2000. See: B. Đurajka, Z. Blažejová & M. Zima, Slovak Republic – Transfer Pricing, Topical Analysis IBFD, last visited 1 October 2017.

²¹ E.g. in Austria in 2010, by virtue of the ministerial decree BMF-010221/2522-IV/4/2010. See: S. Bernegger, W. Rosar & T. Tanzer, Austria – Transfer Pricing, Topical Analysis IBFD, last visited 1 October 2017.

²² A similar approach is applied in Hungary and to some extent in Poland. See: J. Jancsa-Pék, Hungary – Transfer Pricing, Topical Analysis IBFD, last visited 1 October 2017; M. Aleksandrowicz *et al.*, Poland – Transfer Pricing, Topical Analysis IBFD, last visited 1 October 2017.

adequate as a source to be relied upon when preparing domestic transfer pricing provisions, but cannot to be introduced unaltered into legislation.

- 2) Serbia is not an OECD member and due care should be taken when adopting documents in whose drafting the country did not have a voice.
- 3) Other potential sources on transfer pricing were in the final phase of development at the time, primarily the United Nations Practical Manual on Transfer Pricing for Developing Countries (published in 2013).

Thus, the enabling provision of Art. 61a of the Corporate Income Tax Law was tailored to state: “The Minister of Finance shall, relying on sources dealing with the tax treatment of related party transactions from the Organization for Economic Cooperation and Development (OECD), as well as other international organizations, introduce more detailed regulations for the implementation of the provisions of Art. 10a and Arts. 59–61 of this Law.”²³

In addition to granting the soft-law status for the OECD Transfer Pricing Guidelines (as well as other international sources which may gain global recognition in the future), the highly unusual, for Serbian circumstances, explicit mentioning within a piece of legislation of non-binding sources for the Minister to rely on when drafting regulations had one more purpose. Namely, Serbia was evidently far behind other Central and Eastern European countries when it came to following global developments: e.g. the Slovakian Ministry of Finance was responsible for the translation of the 1995 OECD Transfer Pricing Guidelines back in 1997; the Croatian tax authority took upon itself the same task publishing the 1995 OECD Transfer Pricing Guidelines within a broader transfer pricing audit manual;²⁴ while the Bulgarian tax authorities have cooperated since 2008 with their French counterparts on developing transfer pricing legislation and capability.²⁵ In Serbia there have been no initiatives from the tax authorities for the development of expertise and capacity, but rather they were almost exclusively driven by the academic and private sectors. Although it may seem crude, the Working Group wanted to send a strong message to the Serbian tax authorities that they must follow most the relevant global developments with greater care and diligence – and actu-

²³ See: Article 42 of the Law on the Changes and Amendments to the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia*, No. 119/12.

²⁴ *Priručnik o nadzoru transfernih cijena*, Porezni vijesnik – Institut za javne financije, Zagreb 2009.

²⁵ M. Yancheva, Bulgaria – Transfer Pricing, Topical Analysis IBFD, last visited 1 October 2017.

ally stipulating such a message in the legislation itself was thought to be sufficiently to the point.

Finally, in the area of transfer pricing Serbia introduced some of the most demanding compliance obligations in the world. Serbia requires that its taxpayers prepare quite detailed transfer pricing documentation i.e. documentation wherein they are to provide all information on their related party transactions and to demonstrate that these were undertaken in accordance with the arm's length principle. Such documentation is to be submitted annually to the tax authorities together with the Corporate Income Tax balance sheet. In the event of deviation from the arm's length standard, in dealings with related parties resulting in an understatement of the tax basis, taxpayers are obliged to self-adjust their tax obligations within the tax balance sheet for the respective year for which it is being submitted.²⁶

Since in most other jurisdictions transfer pricing documentation is provided to the tax authorities on request and taxpayers are not subjected to such stringent reporting obligations, a logical question arises why was such an approach applied in Serbia. What may be even more puzzling is the realization that the described compliance obligations were not introduced at the insistence of the Serbian Tax Administration, which almost took no part in drafting of the 2012 transfer pricing amendments.

There were two main drivers behind the strict attitude on compliance obligations adopted by the Working Group:

- 1) The first one was the desire to “discipline” Serbian taxpayers ahead of the Serbian Tax Administration developing full capability to competently deal with transfer pricing. By doing so the goal of defending public revenues would be achieved as taxpayers were expected to do their utmost to avoid potential audits and conflicts with the Serbian Tax Administration.
- 2) The second one was to provide an exceptional opportunity for the education of the Serbian Tax Administration. Namely, the Working Group was well aware of the fact that at the time there were virtually no transfer pricing capabilities at the level of the Serbian Tax Administration.

Furthermore, the Serbian Tax Administration was suffering and was yet to suffer from austerity measures introduced by the Government as a part of a broader drive for fiscal consolidation. By subjecting Serbian taxpayers to such broad reporting obligations, the Working Group aimed to provide the Serbian Tax Administration with the finest transfer pricing

²⁶ See: Article 40 of the Law on the Changes and Amendments to the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia*, No. 119/12.

library possible, a library that would allow it to quickly systematize and develop its own approach to numerous transfer pricing issues. The formalization of the transfer pricing documentation template further enabled the comparative analysis of individual taxpayers.

The Working Group expected that the Serbian Tax Administration would jump at such an exceptional opportunity to develop itself essentially at the expense of the taxpayers, as they were to pay the cost of educating the Serbian Tax Administration by being subjected stringent compliance obligations. Furthermore, it was believed that once adequate capabilities were developed, the Serbian Tax Administration would be in the position to ease the taxpayer's administrative burden and propose measures to that effect.

4. ASSESSMENT OF THE SUCCESS OF THE POLICY BEHIND THE 2012 AMENDMENTS TO THE SERBIAN TRANSFER PRICING LEGISLATION

One could easily be tempted to give a positive assessment of the success of the policy behind the 2012 amendments to the Serbian transfer pricing legislation. However, we will try to show why this temptation should be resisted and why a negative stance is far more appropriate.

The 2012 amendments to Serbian transfer pricing legislation have now been in force for almost five years and during this period they have not caused any notable controversy. One of the reasons for this may lie in the very open public debate process from which they had emerged. Despite the previously described burdensome compliance obligations, the business community, particularly foreign investors, seems to be content with the current transfer pricing environment, as opposed to the one in force prior to the 2012 amendments. If we go back to the White Book published annually by the Foreign Investors Council (FIC) in Serbia, we see that apart from a notable praise given to the new transfer pricing legislation in 2013,²⁷ transfer pricing is essentially taken off their agenda in the subsequent years.²⁸ Independent authors have also given a high rating to the 2012 transfer pricing amendments, with Kireta stating, in regard to the supporting regulations, that they have “positioned Serbia as the most

²⁷ See: *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2013, 109.

²⁸ See: *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2014, 116–118; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2015, 132–134; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2016, 158–162.

advanced country in the region in terms of transfer pricing regulations.”²⁹ Cooper and Skopljak have been more critical, although generally positive,³⁰ with their primary criticism directed at a “potentially significant and disproportionate compliance burden” that Serbian transfer pricing documentation requirements may impose on taxpayers.³¹

It has also been widely recognized, although no official data on the matter exists at the moment, that the introduction of the 2012 transfer pricing amendments resulted in a significant increase in corporate income tax revenue collected by the Serbian *fiscus*, with no corresponding implementation costs incurred by the Serbian Tax Administration.

When one takes into account the previously stated, it would seem that at least two of the three policy goals behind the 2012 Serbian transfer pricing amendments have been achieved:

- 1) public revenues have not only been protected, but have increased due to the introduced measures,
- 2) the business community and particularly foreign investors have given a vote of confidence to the adopted provisions.

Unfortunately, we must point out several worrying phenomena, which will illustrate why it is advisable to be far more cautious when it comes to the actual reach of the 2012 Serbian transfer pricing amendments.

Firstly, the primary reason why the Serbian transfer pricing legislation introduced after 2012 has caused so little controversy is that in the past five years the Serbian Tax Administration has not attempted any comprehensive transfer pricing audits. In other words, the new Serbian transfer pricing legislation has not yet been tested in adversary proceedings between taxpayers and the Serbian Tax Administration.

Secondly, the Serbian Tax Administration has made virtually no effort to build up its capacities in the area of transfer pricing: no investments have been made in material infrastructure, and there have been no changes in the internal organization of the Serbian Tax Administration which would enable pooling of talent and resources for the purposes of auditing related party transactions. The compliance burden imposed on the Serbian taxpayers with the intent of this sacrifice to serve a higher purpose has been in vain. To add insult to injury, the Serbian Administra-

²⁹ I. Kireta, “New Transfer Pricing Rules: Confirmation That the Tax System Is Aligning with International Tax Norms?”, *21 Intl. Transfer Pricing J.* 4(2014), Journals IBFD, 302.

³⁰ See: J. L. Cooper, Z. Skopljak, “Transfer Pricing in the Western Balkans: The Current State of Play”, *20 Intl. Transfer Pricing J.* 6(2013), Journals IBFD, 388 – 391.

³¹ See: *Ibid.*, 391.

tive Court has failed to provide any guidance on the interpretation of fundamental transfer pricing principles, despite having at least one clear opportunity to do so since 2012.³²

Thirdly, the legislating of the necessity to follow global developments in Art. 61a of the Corporate Income Tax was to no avail. Even such a drastic measure, rarely seen in the Serbian normative environment, achieved nothing. In the area of international taxation and transfer pricing developments in particular, Serbia, or to be more precise the awareness of the Serbian tax authorities of these developments, is at the absolute end of the line, not only seen from a European, but also from a global perspective.

The reasons for such a harsh assessment can be illustrated with some ease. Namely, less than one year after the introduction of the 2012 Serbian transfer pricing amendments, the heads of governments of the G20 nations, at their 2013 St. Petersburg summit, endorsed the Base Erosion and Profit Shifting (BEPS) Action Plan, prepared by the OECD, which encouraged all countries to join the process. Essentially “in 2013, OECD and G20 governments embarked on the most significant re-write of the international tax rules in a century”³³ with transfer pricing being at the core of the entire BEPS initiative. The uniqueness of the BEPS project cannot be overemphasized as it is remarkable not only from the perspective of the goals it aims to achieve and the breadth of the changes it wants to introduce, but also due to such unprecedented political relevance having been accorded to a tax issue. As the BEPS project has and will have a global impact, the G20 and the OECD opened the doors to all the countries of the world to participate in developing its action plans, through the Inclusive Framework, which has been joined by 102 jurisdictions (as of 6 July 2017).³⁴ A closer look at the list of jurisdictions participating in the Inclusive Framework on BEPS reveals that on the European continent

³² See: III-3 U.28215/10 from 6 December 2013.

³³ OECD/G20 Base Erosion and Profit Shifting Project – 2015, Final Reports – Information Brief, 3, <https://www.oecd.org/ctp/beps-reports-2015-information-brief.pdf>, last visited 2 October 2017.

³⁴ Andorra, Angola, Argentina, Australia, Austria, Barbados, Belgium, Belize, Benin, Bermuda, Botswana, Brazil, British Virgin Islands, Brunei Darussalam, Bulgaria, Burkina Faso, Cameroon, Canada, Cayman Islands, Chile, China (People’s Republic of), Colombia, Congo, Costa Rica, Côte d’Ivoire, Croatia, Curaçao, Czech Republic, Democratic Republic of the Congo, Denmark, Djibouti, Egypt, Estonia, Finland, France, Gabon, Georgia, Germany, Greece, Guernsey, Haiti, Hong Kong (China), Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Israel, Italy, Jamaica, Japan, Jersey, Kazakhstan, Kenya, Korea, Latvia, Liberia, Liechtenstein, Lithuania, Luxembourg, Macau (China), Malaysia, Malta, Mauritius, Mexico, Monaco, Montserrat, Netherlands, New Zealand, Nigeria, Norway, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Poland, Portugal, Romania, Russia, San Marino, Saudi Arabia, Senegal, Seychelles, Sierra Leone, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Turks and Caicos Islands, Turkey, Ukraine, United Kingdom, United States, Uruguay and Viet

only the following countries are (self)isolated from this groundbreaking process: Albania, Belorussia, Bosnia and Herzegovina, Cyprus, Macedonia, Moldova, Montenegro, and sadly Serbia.

Finally, the capabilities of the Serbian Tax Administration to apply demanding legislative solutions are constantly deteriorating due to it being grossly understaffed and underfunded. It has far fewer options at its disposal today than it had in late 2012. Therefore, if the 2012 transfer pricing amendments were too demanding for the Serbian Tax Administration to implement at the time they were introduced, today they represent an essentially insurmountable obstacle.³⁵

The presented evidence shows that the drafters of the 2012 Serbian transfer pricing amendments failed to grasp the fundamental deterioration of the Serbian administrative infrastructure, which is not capable of applying sophisticated and complex solutions. It is our proposition that the current state of affairs is but a lull, caused by the shift in the focus of the Serbian Tax Administration away from transfer pricing, which may be explained both by the desire not to adversely impact foreign investment and avoid all the unwarranted embarrassment that came out the Carlsberg case. In principle the essential goal of durable legal certainty in the area of the taxation of related party transactions has not been achieved. Not only has no transfer pricing capacity been developed by the Serbian Tax Administration, on the contrary, its capabilities today are notably weaker than they were five years ago. Finally, the initial increase in corporate income tax revenue will most likely evaporate once taxpayers fully digest the message sent to them by virtue of the Serbian Tax Administration's inaction. As was the case with the transfer pricing provisions of the Serbian tax legislation during the 1990s and the first decade of the 21st century, the ones introduced in and after 2012 are also in danger of being effectively forgotten and neglected, with only some formal recognition of their existence. However, as the Carlsberg case showed, the fact that a piece of legislation has been forgotten does not affect its legal status and its dormancy can be interrupted by a crude awakening.

5. CONCLUDING POLICY RECOMMENDATIONS

The restrictions imposed on Serbian tax policy makers, by virtue of a weak Serbian Tax Administration, have been noted numerous times by

Nam, <http://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>, last visited 1 October 2017 .

³⁵ For more on the state of the Serbian Tax Administration see: S. Kostić, “Administrativni okvir kao ključna prepreka usklađivanju srpskog poreskog prava sa pravom Evropske Unije”, *Usklađivanje poslovnog prava Srbije sa pravom Evropske Unije* (ur. V. Radović), Pravni fakultet Univerziteta u Beogradu, Beograd 2016, 400–415.

independent observers, within whom the Fiscal Council of Serbia stands out as most vociferous in its calls for strengthening this crucial state authority.³⁶ Unfortunately, we have no indications that the Serbian Government has an understanding of the gravity of the situation and all the potential implications, not only further deterioration, but also maintaining the status quo may have on Serbian economic development and growth. In all fairness, the same can be said of past Serbian Governments as well. One can but lament for the “good old days” when such praise for the Serbian Tax Administration could be voiced by the foreign investors community:

“There are a number of examples of tax inspectors adopting a responsible and more educated approach when conducting audits of taxpayers.”³⁷

The reform of the Serbian Tax Administration will be a long and exhausting process, which will require much treasure and patience. Serbian tax policy makers and those in charge of drafting tax legislation must take into account the crucial element of the capability of the administrative infrastructure that will be in charge of implementing respective provisions. Otherwise we will be introducing norms which either will not be applied at all (or to be more precise, whose application will not be audited) or will be implemented improperly. In either eventuality, we are faced with increasing legal uncertainty and further loss of confidence in the public authorities, both of which adversely impact the business environment and economic growth. What we must not do is attempt to uncritically introduce comparative solutions into the Serbian legal environment, particularly those that stem from jurisdictions with a highly developed tax authority and a tax proficient judiciary.³⁸ Finally, what we should do is come to grips with the notion that Serbia is a developing country

³⁶ See: Fiskalna kretanja u 2016. godini, konsolidacija i reforme 2016–2020, Fiscal Council of Serbia, 20 June 2016, 59–60, http://www.fiskalnisavet.rs/doc/ocene-i-misljenja/2016/Fiskalna_kretanja_2016_fiskalna_konsolidacija_2016-2020.pdf, last visited 2 October 2017); Ocena predloga Zakona o budžetu za 2017. godinu i fiskalne strategije za period 2017–2019, Fiscal Council of Serbia, 9 December 2016, 8–9, <http://www.fiskalnisavet.rs/doc/ocene-i-misljenja/2016/Ocene%20budzeta%20za%202017%20i%20Fiskalne%20strategije%20za%20period%202017-2019.pdf>, last visited 2 October 2017; Fiskalna kretanja u 2017. godini i preporuke za 2018. godinu, Fiscal Council of Serbia, 29 September 2017, 9, <http://www.fiskalnisavet.rs/doc/ocene-i-misljenja/2017/Fiskalna%20kretanja%20u%202017.%20godini%20i%20preporuke%20za%202018.%20godinu.pdf>, last visited 2 October 2017.

³⁷ *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2005, 36; *White Book – Proposals for improvement of the business environment in Serbia*, Foreign Investors Council, 2006, 38.

³⁸ Cf. R. J. Vann, G. S. Cooper, “Transfer Pricing Money – the Chevron Case”, *ITP @ 20 [1996 – 2016]: Celebrating Twenty Years of the International Tax Program of the New York University School of Law* (eds. H. D. Rosenbloom *et al.*), NYU School of Law, 2016, 445.

and begin to focus our attention on the experiences of countries that face same challenges and have similar problems.

On a concluding note, at least in the area of transfer pricing, Serbia should focus more on introducing broad safe harbor rules, because these provide predictability (i.e. legal certainty) and would allow the Serbian Tax Administration to concentrate what resources it has at its disposal on the worst cases of non-arm's length transfer pricing.³⁹ In the area of financial transactions between related parties we have years of positive experience with the functioning of existing Serbian safe harbor rules in the form of thin capitalization⁴⁰ and the publication by the Minister of Finance of the interest rate to be deemed at arm's length for transfer pricing purposes.⁴¹ And here we may provide the final defense of the much criticized transfer pricing compliance obligations, introduced by virtue of the 2012 amendments. Namely, it is due to the fact that the Serbian Tax Administration is in possession of a detailed five year archive on virtually all related party transactions which took place in Serbia, that the preparation of sector specific fixed margins safe harbor rules⁴² could be done far quicker and with greater precision in Serbia than in most other jurisdictions in the world. To end on a more positive note, perhaps the work done in 2012 has not been completely in vain

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³⁹ See: *United Nations Practical Manual on Transfer Pricing for Developing Countries*, United Nations, New York 2013, 74–76.

⁴⁰ Article 62 of the Corporate Income Tax Law, *Official Gazette of the Republic of Serbia* No. 25/2001, 80/2002, 80/2002 – dr. zakon, 43/2003, 84/2004, 18/2010, 101/2011, 119/2012, 47/2013, 108/2013, 68/2014, 142/2014, 91/2015, 112/2015.

⁴¹ Article 61(3) of the Corporate Income Tax Law.

⁴² An approach which would follow that which has been applied in Brazil for two decades. See: *United Nations Practical Manual on Transfer Pricing for Developing Countries*, 358–374.

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