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TAX INCENTIVES FOR KEEPING AND ATTRACTING HIGHLY SKILLED WORKERS: THE CASE OF SERBIA

The recent increased migration of workers has posed a brain drain problem on countries, which lose their citizens to more developed countries offering better working and living conditions. Lowering the tax burden on highly skilled individuals has been one of the most commonly used incentives by both developed and developing countries. The Government of the Republic of Serbia has proposed several tax incentives for providing a more beneficial tax treatment for highly skilled employees with the aim of keeping and attracting them back. The first part of this paper illustrates the problem of emigration, the effects of emigration of highly skilled workers, and the effects of taxation on migration decisions. In the second part, the problem of brain drain and its breadth in the Republic of Serbia is addressed, and a detailed elaboration of newly proposed tax incentives is provided. Furthermore, the author proposes an additional tax incentive.

Key words: *Brain drain. – Highly skilled workers. – Migration. – Tax incentive. – The Republic of Serbia.*

1. MIGRATION

Migration of people is not a phenomenon inherent to the 21st century. People were emigrating from their home countries in pursuit of a better life from the ancient times. However, the breadth of migration has increased in the past few decades due to the demographic and economic imbalances between countries (OECD 2018, 9). Imbalances have been

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broadened further with the development of technology and its unequal dispersion across countries, especially when developed and developing countries are compared. Furthermore, the development of technology and science has reduced the costs of migration. Reduction of transportation and living costs has facilitated the migration of the increasing number of people. Moreover, advancement of technologies has provided methods for staying in contact with family members who remain in the source country while not feeling left out and homesick (OECD 2011, 125). As a consequence, there are more people migrating in search of a better life today than there were before.

Especially prone to migration are highly skilled workers: workers with a tertiary education or a specialised skill set. They are more likely to migrate to a country that offers better living and working conditions than settling in the country in which they were born (OECD 2019, 1; Fink, Miguelez 2017, 10). Better economic, working, development and living conditions are mentioned as the most common reasons for migration (OECD 2011, 125).

Increased migration of highly skilled persons is compatible with the rising demand for highly skilled labour. Countries are in need of workers who would induce the development and growth of their economies, given the much more pronounced lack of a satisfying domestic labour supply. As suggested by Liebig, Sousa-Poza (2005, 7), the growing international division of labour and technological progress nowadays requires an increased number of highly skilled individuals internationally. Highly skilled workers are needed to fill in the managerial, professional, and highly technologized job vacancies (Keery 2017, 65; Romer 2000, 222). By offering better financial conditions, developed countries are encouraged and successful in attracting highly skilled workers from outside their borders, while at the same time keeping their own highly skilled workers. As suggested by Brauner (2015, 4), since the wage gap between countries is not closing, further migrations can be expected.

The home grown labour supply has not been able to meet demand since the 1970s. It was estimated that during the 1990s, 2.5 million highly skilled workers residing in the United States of America were immigrants (Docquier, Rapoport 2009, 248). After the 2008 financial crisis, at the level of the European Union (EU), it was recognised that providing better conditions for growth requires promoting a forward-looking and comprehensive labour migration policy that would respond to the needs of labour markets (European Commission 2010, 17). Consequently, the work permit for highly skilled non-EU citizens was introduced in the EU in 2009, called the EU Blue Card, with the aim of easing the conditions and process of hiring highly skilled workers from the non-EU countries. Germany, for example, more recently introduced a new law that further

relaxes the conditions for hiring highly skilled workers from non-EU countries (for more see Taube 2018).

The need to look for highly skilled labour force outside their own borders is also caused by the fact that today's society is an ageing society (Cerna 2018). An ageing population poses the problem to productivity and growth of economies as there are not enough domestic workers to maintain and spur economic growth.

Labour shortage requires attracting foreign highly skilled workers, but it has also highlighted the need for attracting and retaining students who have migrated for study purposes (Burmam *et al.*, 2018, 50; Cerna 2018, 3). Students are future workers, i.e. the pillars of economic growth, making them indispensable for countries. As suggested by Hawthorne (2018, 7–8), they provide a productivity premium to destination countries as they are far younger and with professional careers likely to span decades, providing fiscal benefits for destination countries for a significant period. Consequently, it does not come as a surprise that the number of countries are offering better conditions for finding a job upon the completion of studies, as well as getting a work permit.¹

Competition between countries in attracting and retaining human capital has emerged as a consequence of policies for attracting highly skilled workers and students (LaRaine Ingram 2016, 225; Brauner 2015, 20; Fink, Miguelez 2017, 2; Docquier, Rapoport 2009, 247). Countries are offering a number of incentives that aim to provide the best economic conditions, infrastructure, scientific institutions and the overall better quality of life for highly skilled workers. Competition is especially burdensome for developing countries as they have to compete with developed countries that are equipped with more and better resources (Liebig, Sousa-Poza 2005, 7). However, understanding the importance of highly skilled individuals, developing countries have started pushing back and providing incentives for keeping their highly skilled workers and students, and even attracting foreign highly skilled workers.

1.1. The Effects of Emigration of Highly Skilled Workers

The most common reason for emigration is a higher salary, i.e. better financial conditions offered in the destination country (Fink, Miguelez 2017, 11). Other reasons such as better working conditions, more and better scientific institutes, more funding for research and development activities, also influence the decision of a highly skilled individual to migrate (Burmam *et al.*, 2018, 42). These are not the only reasons, but they are among the most common ones. Political stability,

¹ Countries like the United States of America, Canada, Australia, New Zealand, the United Kingdom, Germany, France, Italy, the Netherlands, Sweden and many more.

less corruption, better infrastructure, better education institutions, and many other conditions can influence the decision of workers and students to migrate.

The decision to migrate affects two countries: the source country, where the individual was born and educated before deciding to migrate, and the destination country, the country to which the individual moved with the purpose of working and living there. So, while one side loses one highly skilled individual, the other side gains. However, as we will see, the loss for the country of origin can be especially grave as it loses the treasured input for its development which is difficult to compensate.

The positive effect of immigration of highly skilled workers for destination countries has been proven. The studies showed that highly educated immigrants have a positive impact on the growth of innovation in the destination country (Bosetti, Cataneo, Verdolini 2015, 321), especially in highly technologized sectors (Fassio, Montobbio, Venturini 2019, 717). Providing positive effects on innovation, which is an essential part for the growth of the entire economy, immigrants provide the so-called *brain gain* for destination countries (LaRaine Ingram 2016, 225). In addition to inducing innovation growth, brain gain also takes the form of the free increase in the human capital stock and a fiscal gain through taxation of immigrants' income.

However, a different story can be told of the effects of the emigration of the highly skilled workers for the source country. The loss of highly skilled individuals, also known as *brain drain*, is most commonly defined as a migration of highly educated individuals towards countries offering better opportunities to the detriment of the countries of origin, particularly developing ones (OECD 2017a, 198). As suggested by the definition itself, brain drain has a negative effect on the prospects of the source country. Namely, emigration of highly skilled workers slows down the innovation and development of the source country, as there are not enough individuals who can generate development (OECD 2017a, 196–197).

The loss for the source countries can include financial and social loss, as well as a loss in human capital (OECD 2017a, 196). While the source countries have invested in the education of highly educated individuals, incurring costs for their education, after their emigration, such investment becomes a failed investment and a fiscal loss for the source country (OECD 2011, 134). The source country loses the chance to recoup the investment through the taxation of the future income of highly skilled individuals. The loss is always high, if we take into consideration that a tertiary educated individual is more likely to earn higher income compared to other workers, which even with a proportional taxation of personal income, presents a significant loss for the source country.

Developing countries are in danger of an even greater loss, as they lose the necessary human capital to spur the much needed economic growth (Arslan *et al.*, 2014, 4). The lack of highly educated individuals that could perform R&D activities, which are *sine qua non* for innovation and growth of countries, can become detrimental to the development of a developing country (Docquier, Rapoport 2009, 248). The shortage of highly skilled individuals is felt especially negatively in the sectors linked with the wellbeing, such as in the medical field (OECD 2017a, 199). Furthermore, it is argued that brain drain can lead to a reduction of investments in education by governments due to the negative return on the education investments, which can further slowdown the development of a developing country (OECD 2017a, 199–200).

On the other side, there are some arguments in literature about the positive effects of emigration of highly skilled workers for the source country. The most common argument is that emigrants, in most cases, send remittances to their families in the source country which presents an influx of foreign capital (OECD 2017a, 186; Docquier, Rapoport 2009). It is argued that remittances present a significant source of capital for developing countries, which would not have been obtained otherwise. In order to maximise the benefit from remittances, it is argued that their tax burden in the source country should be reduced (OECD 2017a, 202–203).²

Data gathered on the use and effect of remittances is not very comprehensive. According to existing data, the biggest part of remittances is used for everyday consumption, providing a positive effect on reducing poverty in the country of origin (OECD 2017a, 187; Kostić 2019a, 30). However, the data on the impact of remittances on investment and growth of the economy is unclear. While the positive effects on the economic growth of countries have been advocated for, there is no data that would support it. Available data shows that only a percentage of remittances is used for acquiring land or properties (OECD 2017a, 187) which can be perceived as investing the money acquired from remittances for capital investments. However, there is no data to support the claim that remittances are used for starting a business, an investment that would have a much more significant effect on economic growth. For these reasons, it does not seem that remittances compensate for the loss that the source a country incurs after the emigration of highly skilled workers, so that the net effect for the source country might be, at least, neutral.

Consequently, for a developing country wishing to foster development and growth, it is necessary to introduce adequate policies that will enable it to retain its own highly skilled individuals. However,

² For a different view on the taxation of remittances, which calls for increasing their tax burden, see especially Kostić (2019a, 30–39).

such a policy would have to base on an interdisciplinary approach, given the need to address many issues that encourage highly skilled individuals to emigrate.

1.2. Effects of Taxation on Migration

Providing better financial conditions, such as higher wages is one of the many incentives that could be used in incentivising highly skilled individuals to stay or return to the source country. Lowering tax burden and providing an individual with increased disposable net income can be seen as instrumental in providing better living and working conditions. A lower tax burden can attract highly skilled individuals with the promise of better quality of life. Concurrently, high tax burden can be seen as a disincentive for the highly skilled to migrate. In that regard, tax incentives can be seen as helpful – although not decisive – for fighting brain drain. Reducing the tax burden for the highly skilled, leaving them better off, can be a step in the right direction when it comes to their decision not to emigrate.

The effects of taxation on migration have been studied in literature, mostly concerning the question of the impact of taxes on a decision to migrate (see especially Wilson 2009; Liebig, Sousa-Poza 2005; Egger, Radulescu 2009; Halkyard 2013; Kleven *et al.* 2013; OECD 2017b). Literature suggests that taxation does play a role for migration of workers in a way that lower tax burden attracts more immigrants, especially the highly skilled ones (see especially Liebig, Sousa-Poza for intrastate migration).

According to the findings of Egger, Radulescu (2009, 1377), the progressivity of a tax system on high income brackets has the biggest impact on the decision to migrate, followed by the overall burden of personal income tax borne by an employee. Highly skilled emigrants are concerned with the net amount of their salaries, the amount that would remain for consumption after all taxes and contributions have been paid. If the net amount is not increased in the destination country, the incentive to emigrate is lowered.

As a result, the volume of tax incentives offered by both developed and developing countries for attracting foreign highly skilled workers does not come as a surprise (Burmam *et al.*, 2018; 42, Halkyard 2013, 23). The consequence is the war for talent as countries have to compete in offering better conditions if they wish to attract and retain highly skilled individuals. A long list of countries, such as Australia, China, Belgium, Denmark, Finland, Italy, Israel, the Netherlands, Poland, Portugal, Spain, Sweden, the United Kingdom and New Zealand offer tax incentives that are similar in nature. The most common tax incentives are

the tax exemption for foreign source income, a reduction in personal income tax and additional incentives for employee in R&D (CESifo 2012, 70).

However, most of the tax incentives that are offered are limited in time due to their revenue cost. In Denmark, the tax scheme for attracting highly skilled individuals had a positive effect on the number of highly skilled immigrants (see especially Kleven *et al.* 2013), but only in the short term. The scheme did not motivate immigrants to stay in Denmark in the long term. However, Halkyard (2013, 30–31) advocates for the use of tax incentives even if only short term positive effects are available, due to the sharing of knowledge and the more fluid social and economic environment that is created with the migration of highly skilled workers. This fact provides an additional argument for the use of tax incentives, but not diminishing the importance of creating other positive changes in a country.

2. FIGHTING BRAIN DRAIN IN SERBIA

2.1. Emigration from Serbia in Numbers

The Republic of Serbia is an emigration country (the Government of the Republic of Serbia 2017, 26). There are more people emigrating from the Republic of Serbia, than the ones immigrating to it, especially highly skilled individuals. The vast number of highly skilled workers and students, either after graduating or leaving for studies abroad, decide to leave Serbia in search of a better life. This has been confirmed by the study performed by Gallup (2017), in which it was calculated that Serbia ranks 30th among 152 countries according to the potential net migration index.³ Namely, the study looked at the number of people who would have emigrated had they been able to do so. According to the statistics, 27% of highly skilled workers and 46% of young people (between 15 and 29 years old) would have emigrated from Serbia had they had a chance.

Existence of a brain drain problem in Serbia has also been acknowledged by the European Commission in the Serbia 2019 Report, which states that brain drain remains an economic challenge for Serbia (European Commission 2019, 48). Even though the problem of emigration of highly skilled Serbian citizens to other countries is perceived as a problem in Serbia, there are no official national statistics that would provide precise data on the extent of the emigration. Institutions such as the Organisation for Economic Cooperation and Development (OECD), and Eurostat, the EU Statistical Office, provide some information about

³ For more information see Gallup 2017.

emigration from Serbia in their reports and analyses of international migration.

According to the statistics provided by the OECD (2015, 41) for the period 2000–2010, Serbia was among the countries with the highest increase in the emigration rate, for both the total number of emigrants (third place out of the top 15 countries) and for the number of highly skilled emigrants (fifth place, with only one European country, Moldova, having a higher rate). According to the more recent statistics, Albania and North Macedonia are among the European countries that have a higher percentage of emigrants than Serbia.⁴ The most recent data, provided by Eurostat, shows that 4,000 people per month emigrated from Serbia in 2018 and 2019, adding up to 51,000 people annually, and highlighting the extent of the emigration from Serbia.⁵

Even though it does not represent a comprehensive study on the topic of emigration from Serbia, important information has been provided in the study *Migration of Students*, carried out by the two ministries in the Republic of Serbia (Cabinet of the Minister in Charge for Demography and Population Policy and the Ministry of Education, Science and Technological Development). In the study, 11,013 students in Serbia were interviewed on the subject of emigration. According to the findings, around 31% of all students interviewed plan on leaving Serbia after graduating (*Migration of Students 2018*, 24), with 50,6% of them not planning to return to Serbia (*Migration of Students 2018*, 46). The main reasons for emigration are of economic nature, and they concern the prospects of finding a job in the industry for which the students qualified, low salaries in Serbia for jobs for which they qualified and a general low standard of living (*Migration of Students 2018*, 42). The information that supports the findings of the Gallup study is that 90% of the students that want to emigrate have the full support of their parents (*Migration of Students 2018*, 41). A negative finding is that only 4.3% of students would change their decision to leave if an adequate loan or other financial help was provided. The main destination countries for emigration are Germany (24%), the United States of America (11.2%), Switzerland (10.7%) and Austria (8.7%).

The data obtained in the study shines some light for the prosperity of Serbia. According to the answers provided by the interviewed students, 51.6% of them would not emigrate if a job for which they qualified were available (*Migration of Students 2018*, 47). A number of them highlighted the need for better scientific institutes, more respect for every occupation, less corruption, better quality of life and hiring on the basis of merit and

⁴ Gallup 2017.

⁵ More information available at: <https://ec.europa.eu/eurostat/data/database> (last visited 20 September 2019).

not on the basis of political affiliation. These results show that there is space for improving the conditions for living and working in Serbia. However, it shows that the changes and the effort must involve all of society, including the government, different institutions, the private sector and citizens.

Another reason for working on providing better conditions can be found in the cost that highly educated people pose when they emigrate after finishing their studies in Serbia. Important information is provided in the study *The Costs of Youth Emigration*, carried out by the Institute for Development and Innovations, in cooperation with the Westminster Foundation for Democracy, in 2019. The study notes that it is estimated that during the 2012–2016 period, around 245,000 people emigrated from Serbia. Especially important findings of the study are the findings on the costs for the Republic of Serbia of each highly educated individual who emigrates. It is calculated that the cost for the budget of the Republic of Serbia of one highly educated person who emigrates amounts to around EUR 34,000, while the cost is increased up to around EUR 55,000 for each PhD student (Institute for Development and Innovations 2019, 21). Moreover, it is calculated that the aggregate cost of emigration of highly educated people for the budget of the Republic of Serbia is somewhere between EUR 960 million and 1.2 billion (Institute for Development and Innovations 2019, 23).

2.2. Proposed Tax Incentives

Targeting the right problems and providing adequate solutions is the path that the Government should follow. The results provided by the mentioned studies on emigration from Serbia could prove to be very helpful for the Government when designing incentives for retaining highly skilled individuals and attracting the return of the ones already abroad.

Tax incentives, as mentioned above, can have an impact on the decision to emigrate. Given that developed countries are offering tax incentives for highly skilled workers so as to attract them, the Republic of Serbia has started the work on introducing tax incentives that can help them decide to stay or to come back to Serbia.

In 2018 the Republic of Serbia introduced an entire set of tax incentives for the knowledge based economy which should help boost the growth of innovation in the Republic of Serbia. These incentives can be expected, at least indirectly, to provide better working and living conditions in Serbia through incentivising business development in Serbia. Tax incentives such as a double recognition of R&D costs, with salaries for individuals performing R&D activities benefiting from the

incentive, is expected to have a positive effect on the desirability of hiring highly educated individuals, and consequently on the increase in income of those individuals. Furthermore, an incentive for investing in newly established innovative companies (start-ups) is provided, as well as the more beneficial tax treatment of employee stock options plan. Another incentive offered is the IP Box which reduces the corporate income tax rate to about 3%, compared to the regular 15%, for income acquired from licensing of intellectual property rights that were developed in the Republic of Serbia.

Given the large number of people who emigrated from developing countries, attracting them to return is of great importance for the country of origin due to the fact that they bring back the financial, social and human capital (OECD 2017a, 192). One of the most important aspects of the financial capital that is brought back is the way that businesses are started upon return and investment in entrepreneurship. According to the studies, returning emigrants are more prone to starting their own businesses upon return (OECD 2017a, 193). For this reason, it can be expected that the newly introduced incentives for knowledge based economy will have at least an indirect effect on the desirability of living and working in Serbia which would also help economic growth.

The return of highly skilled workers can also have a positive effect for the source country through the sharing of knowledge and consequent development. After the return, repatriates can lead to an increase in the human capital stock in the source country due to the sharing of knowledge and skills that they are bringing back (OECD 2017a, 194). For that reason, an additional incentive has been proposed in this paper which aims to ease the conditions for investing in the skills and education of future employees by legal entities in order to support the growth of human capital in Serbia.

Acknowledging the importance of returning emigrants, as well as of attracting highly skilled individuals from other countries, the Government of the Republic of Serbia has proposed the introduction of a set of tax incentives by the end of the 2019, aimed at relaxing the financial conditions for returning highly skilled emigrants and reducing costs of hiring new employees.

2.2.1. Deduction of 70% of Salary Tax for New Residents

One of the proposed tax incentives is directed at providing a better financial position for the highly skilled workers returning or moving to Serbia. Moving to another country involves costs that have to be borne by the emigrant. In order to facilitate the process of moving, countries have started offering incentives that aim to reduce the moving costs or lowering the costs of living and working in the destination country.

Incentive proposed by the Government of the Republic of Serbia follows the logic of the ‘30% ruling’ adopted in the Netherlands. Incentive offered in the Netherlands allows up to 30% reduction of the tax base for salary tax purposes as compensation for moving costs to the Netherlands. To benefit from the incentive, the taxpayer has to have been living outside of the Netherlands for no less than 16 months before starting to work in the country, and to possess specific expertise that is not available or only scarcely available in the Netherlands. Whether the specific expertise condition is fulfilled is proven by a minimum salary that repatriates must earn in the Netherlands, while such a limitation does not exist for individuals performing scientific research at a designated research institution. In the Netherlands, this incentive is offered for five years.⁶

Portugal also offers beneficial tax treatment to new residents. According to the incentive, new residents performing highly qualified activities in the field of science, technology and arts in Portugal, can benefit from a flat income tax rate of 20%, instead of the regular 40%. To benefit from the lower tax rate, the individual must not have been a tax resident of Portugal for five years before moving to the country.

Another interesting tax incentive is provided in Italy for inbound repatriates and foreign highly skilled workers, with the aim of putting a stop to brain drain.⁷ The incentive targets highly skilled individuals and should in turn have a positive effect on the development and progress of the country. This incentive has been offered since 2016 as a 50% reduction of taxable employment and self-employment income, while in 2017 the tax deduction was further increased, leaving only 30% of the employment income taxable.

To benefit from the Italian incentive, the highly skilled individual has to hold a degree, high qualification, specialization or to perform managing roles and to be employed or perform activities for an Italian resident company or a company related to it. Incentive is offered to highly skilled individuals from both EU member states and non-EU countries with which Italy has signed a double tax treaty or an information exchange agreement. Furthermore, the highly skilled worker must not have resided in Italy for five years before moving to the country, while planning to remain in Italy for at least two years after becoming Italian tax resident.

⁶ For more information about the ‘30% ruling’ offered in the Netherlands see at: https://www.belastingdienst.nl/wps/wcm/connect/bldcontenten/belastingdienst/individuals/living_and_working/working_in_another_country_temporarily/you_are_coming_to_work_in_the_netherlands/30_facility_for_incoming_employees/ (last visited 23 September 2019).

⁷ Law No. 232. 2016. Bilancio di previsione dello Stato per l’anno finanziario 2017 e bilancio pluriennale per il triennio 2017–2019 [State budget for the 2017 financial year and multi-year budget for the 2017–2019 three-year period]. *Gazzetta Ufficiale Serie Generale* No. 297, 21 December 2016 – *Suppl. Ordinario* No. 57.

The right to use the tax incentive is allowed for five years, starting from the year in which the highly skilled individual became the tax resident of Italy.

Taking into consideration the abovementioned incentives and their effects, the incentive proposed by the Government of the Republic of Serbia can be said to follow their logic. Incentive is offered through the reduced tax burden for highly skilled individuals that are of great significance for the development of the economy.

The proposed tax incentive requires an amendment to the Law on Personal Income Tax⁸. According to the incentive, the regular salary tax base is reduced for 70%, leaving only 30% of salary income taxable for highly qualified workers. To qualify for the deduction, the highly skilled individual has to obtain a full employment contract for an indeterminate period. The right to use the benefit is limited to five years from the day of the signing of the employment contract.

To be regarded as a highly skilled individual, the individual has to occupy a position for which a specific professional education is required and for which there is a demand that cannot be easily satisfied in the domestic labour market in Serbia. In order to avoid complex definitions that would, most likely, unintentionally preclude individuals from some occupations to benefit from the measure, the solution used in the Netherlands has been adopted. Namely, the salary obtained by the individual is used as a criterion: if the salary of an individual is higher than the three average monthly salaries per employee in Serbia (in the case referred to in paragraph a) below), or higher than the two average monthly salaries in Serbia (in the case referred to in paragraph b) below), that individual will be regarded as a highly qualified individual.

Further explanation of a highly skilled individual is provided in the provisions. In order to benefit from the incentive, the individual who moves to Serbia should fulfil one of the two requirements that: a) 24 months before the day of signing of the contract with a qualified employer, they did not mainly reside in the territory of the Republic of Serbia, or b) 12 months before the signing of the contract with a qualified employer they mainly resided outside the territory of the Republic of Serbia for reasons of further education or advanced training, and at the moment of signing of the contract with a qualified employer, they are younger than 40 years old.

⁸ Zakon o porezu na dohodak građana [Law on Personal Income Tax], *Official Gazette of the RS*, 24/2001, 80/2002, 80/2002, 135/2004, 62/2006, 65/2006, 31/2009, 44/2009, 18/2010, 50/2011, 91/2011, 7/2012, 93/2012, 114/2012, 8/2013, 47/2013, 48/2013, 108/2013, 6/2014, 57/2014, 68/2014, 5/2015, 112/2015, 5/2016, 7/2017, 113/2017, 7/2018, 95/2018 and 4/2019.

As it can be noted, this incentive is open to nationals of all countries, and not just to Serbian citizens. However, individuals moving to Serbia have to be regarded as Serbian tax residents in accordance with the centre of personal and economic interest rule, and in accordance with all Serbian double tax treaties.

To benefit from the incentive, the highly skilled individual has to be employed with a qualified employer. A qualified employer is an employer who is a tax resident of the Republic of Serbia and who is not a related party to the previous employer of the highly skilled individual. Namely, the incentive is not extended to employers who are relocating employees to their related parties in Serbia, as it is assumed that they would have done so even without the incentive, should there be a reason for their relocation.

Nonetheless, there is an exception to this rule. Any employer will be regarded as a qualified employer in the case of a highly skilled individual who, in the 25 years preceding the year in which the contract is signed, has been a tax resident of the Republic of Serbia for at least three years (having a domicile or a centre of personal and economic interests in Serbia). Namely, if an employee was, in any period of their life, regarded as a tax resident of the Republic of Serbia for three years (not necessarily consecutive years), it will be possible to use the incentive even if the employer does not fulfil the abovementioned condition. The main objective of the incentive is to attract Serbian emigrants to return to Serbia, and with this exception, the incentive is open to those who once lived in Serbia, but who emigrated and worked for an employer who is regarded as a related party to the new employer in Serbia.

The issue of the relevant compulsory social security contributions regime is related to the deduction of the tax base for salary tax. In order to truly decrease the costs for employers and employees, it is proposed that the base for social security contributions be reduced by 70% for highly qualified employees. Consequently, the tax base for compulsory social security contributions would be reduced as well, and an incentive would be offered to both employees and employers through the reduction of salary tax and social security contributions.

2.2.2. Special Treatment of Capital Gains of New Residents

The second proposed incentive addresses the widespread international business practice of awarding employees with own securities for free or under preferential regime (Kostić 2019a, 54). The practice serves as a measure for uniting the interests of employers and employees which should provide a positive effect on the growth of the business. By sharing the ownership of the company with employees, employees are motivated to work harder in order to increase the value of the shares so

that they gain from it too, while the employer benefits from more loyal and productive employees.

Even though such practice is not widespread in the Republic of Serbia, by inviting highly skilled emigrants to return to Serbia, there is a need for adjusting the existing legal framework, as some of them might own securities that they do not wish to sell before moving back to Serbia. Moving to Serbia while owning the securities would make the securities subject to the capital gains tax in Serbia upon their sale, even though they were not acquired in Serbia, nor by a Serbian tax resident at the time of their acquisition.

According to Article 72 of the Law on Personal Income Tax, the taxpayer is required to pay capital gains tax on the sale of securities that they have owned for less than 10 years. In that case, the tax base for capital gains tax is the difference between the purchase price (at the time of the acquisition) and the sale price, with a tax rate of 15% (Articles 72–77 of the Law on Personal Income Tax).

The newly proposed measure adjusts the purchase price with the aim of lowering the burden for capital gains tax for the sale of securities issued by a non-resident company that the taxpayer acquired for consideration. If, at the time of acquisition and six months following the acquisition of those securities, the taxpayer was not a tax resident of the Republic of Serbia, the purchase price will be the market price on the day when the taxpayer became the tax resident of the Republic of Serbia.

The step up in basis allows for taxation of only the part of the increased value of the capital after the taxpayer became a tax resident of the Republic of Serbia. It provides the taxpayer with a beneficial treatment as the difference between the purchase price at the time of the acquisition, and at the time of becoming a tax resident of the Republic of Serbia will be different, i.e. the price will be higher in the latter case, which would reduce the difference which is subject to the capital gains tax. As a consequence, the taxpayer will be subject to a lower tax burden, which should reduce the costs for moving to the Republic of Serbia.

2.2.3. Tax Exemption for Start-up Employees – Founders

In 2018, the Republic of Serbia introduced a set of tax incentives intended to foster the growth of the knowledge based economy. Special attention was paid to tax treatment of newly established companies that perform innovation activities, commonly known as start-ups. Start-ups are set up by a small number of individuals around an innovative business idea. However, a significant amount of capital is required to develop an innovative business idea, which represents the most common obstacle to the development of start-ups. Targeting the capital requirement, incentives were introduced for reducing the costs for start-ups and providing them

with the much needed capital. These incentives introduced the tax credit for investments in start-up capital, a double deduction of R&D costs and a reduced tax burden for royalties.

The Government has proposed an additional incentive for reducing the costs for start-ups even further. It is proposed that the tax burden for salaries of founders of a start-up is reduced. Start-ups would be exempted from paying the calculated and deducted salary tax for salary of founders which are employed in the start-up. The employee-founder has to sign an employment contract and to be registered for compulsory social security insurance. Further, the employee– founder has to own at least 5% of shares or stocks in the start-up. If there are multiple founders which are employed in the start-up, the benefit is provided for each one.

The tax exemption applies to monthly salaries up to 150,000 RSD. If the salary is higher, the tax exemption is provided only for the amount of 150,000 RSD, while the tax exemption does not apply for the remaining part of the salary. If one individual is founder of two or more start-ups, only one start-up has the right to use the benefit for that individual; the other start-ups cannot benefit from the tax exemption for the same individual.

The start-up has to be registered with the competent authority and it cannot be regarded as a related party to any legal person, in accordance with the Law on Corporate Income Tax. Also, it must not derive more than 30% of its total income from other entities that are regarded as related parties to any of its founders. The right to use the benefit is available for 36 months from the incorporation of the start-up, which cannot be later than the 31st December 2020.

This incentive cannot be cumulated with any other incentive available for hiring of the same individual, except for the incentives prescribed in the law governing compulsory social security insurance, even if they are prescribed as a subvention for employment or self-employment. Given that the Law on Personal Income Tax in Article 21dj already allows the tax exemption for salaries of founders of newly established companies, it was necessary to limit their mutual use. However, given that the tax exemption from Article 21dj is allowed only for salaries of employees-founders up to 37,000 RSD, and only for 12 months from the incorporation of the company, it is clear that the newly proposed incentive will be of greater benefit to start-ups.

Contributions for social security insurance impose a higher cost on employers and employees. In order for the tax incentive to be efficient in actually reducing the overall costs, it was necessary to provide a complementary incentive for contributions for social security insurance. For that reason, the tax incentive has been transposed in the field of the compulsory social security insurance. Namely, the incentive proposes to exempt the employer from paying social security contributions, on both

employer's and employee's accounts, for salaries of founders-employees up to 150,000 RSD. If the salary is higher, the part above the limit will not benefit from the exemption. The same conditions have to be fulfilled as for the salary tax incentive. While benefiting from the incentive, contributions for the compulsory social security for founders-employees will be payable from the budget of the Republic of Serbia for the lowest monthly base for contributions.

2.2.4. Tax Exemption for Salaries of New Employees

The proposed tax incentive for individuals moving to Serbia, which provides a 70% salary tax deduction, is open solely to taxpayers who are new tax residents of the Republic of Serbia or repatriates. Namely, current tax residents of the Republic of Serbia are excluded from the scope of that incentive. While not diminishing the value of attracting emigrants to return to Serbia, in order to provide overall better working and living conditions in Serbia, so that other individuals do not emigrate, an additional tax incentive is proposed.

Tax incentive introduces a beneficial tax treatment of salaries for newly employed individuals, mainly targeting younger citizens⁹ and individuals who were working, i.e. performing services, as entrepreneurs. An increasing number of entrepreneurs was noticed in Serbia, with individuals registering as entrepreneurs for providing services to their contractors, as it allowed them to avoid an employment relationship and the increased accompanying costs. The situation has led to the abuse of the entrepreneurship status, i.e. to the bogus self-employment¹⁰. The problem with the practice is that the relationship between the entrepreneur and the contractor is practically the one between an employer and an employee. Namely, in practice, entrepreneur does not act independently from the contractor in performing activities. The contractor is the one who undertakes all the risks and who organizes the work of the 'entrepreneur', and not, as it should be, the entrepreneurs themselves.

Bogus self-employment is not a phenomenon unique for Serbia; it is present in other countries, which started introducing measures for putting an end to it. The most famous decision in the area of bogus self-employment is the decision of the Court of Appeal of the United Kingdom in which the practice of hiring Uber drivers as entrepreneurs was seen as a disguise of an employment contract between Uber and its drivers.¹¹

⁹ At the moment, unemployment rate of people between 15 and 24 years old in Serbia is high, 22.4%.

¹⁰ For more about bogus self-employment and the ways to tackle it see especially Collins, Horodnic 2017.

¹¹ The decision of the Court of Appeal of the United Kingdom available at: <https://www.judiciary.uk/wp-content/uploads/2018/12/uber-bv-ors-v-aslam-ors-judgment-19.12.18.pdf> (last visited 29 September 2019).

The current legislative framework in the Republic of Serbia allows individuals to register as entrepreneurs and pay less taxes and contributions than employees and their employers. For that reason, companies will gladly choose the role of a contractor rather than employer, and individuals will rather choose higher net disposable income than incurring higher costs for salary tax and accompanying contributions. Such a disproportionate status of contractors/employers and entrepreneurs/employees, pointed to the need of equalising their statuses and preventing the discrimination against employers and employees, at least for tax law purposes.

Equalising the position of employees and entrepreneurs who have abused the rules, is expected to have an additional positive impact through the increase in labour rights. New rights would become available to new employees (previously entrepreneurs), such as maternity leave, public health insurance (which is still better compared to the private health insurance which does not cover a vast number of more complex medical issues), severance pay, and other rights available to workers in an employment contract, but not to entrepreneurs.

Furthermore, providing a legal solution for bogus self-employment is expected to increase legal certainty in the tax system as well. Taxpayers would have all the necessary information to choose the legal form that best suits the activities that an individual wishes to perform. Taxpayers would know precisely when they are allowed to register as entrepreneurs and when they fall under the normal employee rules, as well as the tax consequences of both statuses.

For the mentioned reasons, a measure has been proposed by the Government which ‘tests’ the level of independency of registered entrepreneurs in providing services to their contractors. According to the proposed measure, if an entrepreneur ‘fails’ the test, their income will be regarded as ‘other income’ for the purposes of the Law on Personal Income Tax which induces an increased tax burden (the tax rate is 20% compared to regular 10%), as well as increased social security contributions.

Introduction of this measure would affect the disposable net income of former entrepreneurs (new employees), as well as the cost for their former contractors, i.e. new employers. In order to provide a transitional solution that would enable entrepreneurs and their contractors to get used to the new circumstances and the new test, the Government has proposed a measure that reduces their (increased) costs during a medium term period of three years.

The new tax incentive provides a tax exemption for employers from paying (in a certain percentage) the calculated and deducted salary tax for qualified individuals. The tax exemption is granted for 36 months,

and exempted percentages depend on the year in which the salary is payable. For the year of 2020, the amount is 70% of calculated and deducted tax, for 2021 that is 65%, and for 2022 it is 60%. By providing this type of incentive, employers are indirectly granted a subvention that would neutralise the latest increased costs.

The incentive is open only for employers who hire qualified individuals. A qualified individual is defined as a newly employed individual who was not registered as an insured employee during the period from 1 January to 31 December 2019, but which gained the status of a registered employee of the qualifying employer or any other employer during the period from 1 January to 30 April 2020. Namely, entrepreneurs were not registered as employees for the purposes of social insurance while providing services as entrepreneurs, which makes this measure available to them, as well as to other individuals who have found their first job.

The right to use the incentive is available to qualifying employers, which are defined as any an employer, legal or physical person, which during the period from 1 January 2020 to 31 December 2022 signs an employment contract with a qualified individual and registers the employee for compulsory social security contributions with the competent authority. Furthermore, the employer has the right to use the incentive if it increases the total number of employees after hiring a qualifying employee, compared to the number of employees on 31 December 2019. The right to use the benefit is also available to any employer which starts to conduct business activities after the 31 December 2019.

If the employer, while using the incentive, decreases the number of employees compared to the number it had on 31 December 2019 (increased for the number of qualified employees), the employer loses the right to use the incentive for an equivalent number of qualified employees. In the case of an employer who started performing business activities after 31 December 2019, the relevant date is 31 December of the year in which it started performing business activities.

This incentive cannot be cumulated with any other incentive offered for hiring individuals, except from the one offered in the law governing compulsory social security contributions, nor can it be used by public authorities.

In order to reduce the overall employment costs, and not just the salary tax, exemption from paying contributions for pension and disability insurance of qualified employees has been provided to employers. Exemption is provided to both employer's and employee's accounts, but only for pension and disability insurance contributions. Given that pension and disability insurance contributions amount to 70% of total social

security contributions, it can be argued that an important reduction has been provided. Additional reduction in contributions for health insurance is avoided as it would have had a negative effect, given that the reduced revenue of the Republic Fund for Health Insurance would have had to be compensated from the budget of the Republic of Serbia, which does not happen normally, unlike the case of pension insurance.

To benefit from the incentive, the same conditions as for the incentive regarding the salary tax must be fulfilled, while the exempted percentages differ. For salaries paid in the year of 2020, 100% of contributions for pension and disability insurance are exempted, for 2021 the figure is 95%, and for 2022 it is 85%. In that period, contributions for compulsory pension and disability insurance for employees are payable from the budget of the Republic of Serbia. This incentive cannot be cumulated with any other incentive (except the complementary incentive for salary tax) intended for hiring the same individuals.

2.2.5. Tax Exemption for Foreign Source Income of Non-residents

Rapid technological advancement has changed the way of doing business and performing services. The need to be in one place physically to perform work tasks does not stand in many cases. The Internet has enabled individuals to work from anywhere in the world using their personal computers, which has posed problems for controlling and taxing the income of those individuals.¹²

Serbia is one of the countries that find it difficult to track the income of persons performing activities while temporarily staying in Serbia, leading to non-taxation even though the right to tax exists. For that reason, it is seen as a good practice to formally exempt the income received by a non-resident individual from abroad, while temporarily staying in the territory of the Republic of Serbia. This measure would equalise the legal framework with the reality and increase tax certainty. Furthermore, it is believed that this measure would provide an incentive for foreign individuals to come and work in Serbia temporarily. Even though they would not pay income taxes, the benefit for the Republic of Serbia would be provided through the increased VAT revenue from their consumption in Serbia.

The proposed incentive introduces exemption from personal income tax for income obtained by a non-resident individual who spends a maximum of 90 days in the Republic of Serbia, in the period of 12 months starting or ending in the respective tax year. To benefit from the exemption, the work has to be performed for a non-resident contractor who does not perform main business activities or other activities in the Republic of Serbia.

¹² For more see: Kostić 2019b.

If the non-resident contractor performs activities in the Republic of Serbia, the income of a non-resident individual will be exempted if the service performed is not used for contractor's main business activity or other activity that it performs in the territory of the Republic of Serbia. Introducing the limitation that the non-resident principal does not perform business activity in the Republic of Serbia aims to safeguard the equal position of resident and non-resident entities by reducing potential for discrimination.

2.3. Proposal of an Additional Tax Incentive: Tax Incentive for Investing in Training and Education of Future Employees

An additional tax incentive is proposed in this paper, with the aim of supporting highly skilled persons remaining in the Republic of Serbia and attracting those who have left.

The incentives proposed by the Government (explained above) aim to reduce costs for employers and indirectly providing more disposable net income to employees. Having in mind that economic conditions are not the only one affecting the decision to emigrate, it is necessary to build an environment where the further development of skills and lifelong learning are encouraged. Employers should be encouraged to invest in further specialisation and education of their employees and future employees as it would provide them with more skilled workers. Employees and future employees, on the other hand, would benefit from the personal development, which would enable them to advance their careers, earn higher income and secure higher quality of life in Serbia, which would reduce the brain drain from the Republic of Serbia.

Incentives offered by employers to their employees as a way of tuition fee assistance have been proven to provide a positive return on investment. According to the study performed by the Lumina Foundation regarding the tuition fee assistance provided by a health care insurance provider to its employees in the United States of America, it was shown that the investment paid off with a 129% return to the employer, while the employees benefited from a 43% salary increase in the three following years (Lumina Foundation 2016, 9–10). Furthermore, a study by the OECD showed that government investment in skills is a sound investment, as every dollar invested is more than fully repaid by the increased future tax revenue (OECD 2017b). Having in mind these facts, there is an incentive for introducing similar measure into the legal framework of the Republic of Serbia as both employees (present and future) and employers benefit from the incentive: the former through the further specialisation and reduced salary tax, and the latter through reduced employment costs and better qualified personnel. Moreover, a gain for the Republic of Serbia would be obtained through the reduced brain drain that would allow its faster economic growth. Individuals would have a secure job in

the field for which they qualified, directly disincentivising them from emigrating.

The current legal framework of the Republic of Serbia does not recognise any specific incentive for investing in the education or specialisation of current and future employees. However, in line with the current provisions, an employer that invests in the work related education or specialisation of its current employees will be allowed to deduct the amount invested as an expenditure if the money was paid directly to the institution or organisation providing the course.¹³ Furthermore, the amount invested will not fall into the tax base for salary tax of the employee who benefits from the investment. If, however, the money was paid into the account of an employee, who would pay the course cost himself from the money obtained from the employer, the employer would not have the right to deduct the amount as an expenditure, and the amount obtained would fall into the tax base as an in-kind benefit for salary tax purposes, inducing an increase in the compulsory social security contributions. As a result, only employees whose course cost has been covered directly to the institution providing the course will be able to benefit from the employer's investment in their education or specialisation.

Investment in education or specialisation of individuals who are not current employees of a legal entity, such as students, would have to incur the personal income tax (for the part exceeding the legally prescribed monthly maximum of around EUR 100) according to Article 85 of the Law on Personal Income Tax, as 'other income', with a 20% tax rate. Furthermore, it is unclear whether the legal entity would be able to deduct the invested amount as an expense. It can be argued that if a contract in which the individual commits to working for the investor after completing the course is provided, the employer would have the right to deduct the invested amount. If there is no similar contract, there would be no sufficient relationship with the business activity, and the expenditure would not be permitted. We can notice that there is no actual incentive for legal entities to support the specialisation of individuals who could become an invaluable asset for the business activity.

The situation is not much better even if a legal entity wishes to invest in entities that are registered for providing education services. In that case, legal entity has the right to deduct the sum invested as expenditure, but the maximum deductible amount is capped at 5% of investor's total revenue.¹⁴ It is noticeable that these rules do not provide

¹³ Opinion of the Ministry of Finance of the Republic of Serbia, No. 414–00–88/2002–04.

¹⁴ Zakon o porezu na dobit pravnih lica [Law on Corporate Income Tax], *Official Gazette of the RS*, 25/2001, 80/2002, 80/2002, 43/2003, 84/2004, 18/2010, 101/2011, 119/2012, 47/2013, 108/2013, 68/2014, 142/2014, 91/2015, 112/2015, 113/2017 and 95/2018, Art. 15.

an actual incentive for companies to engage in direct or indirect investments in human capital.

The desirability of an incentive that would further support investments in human capital in Serbia is supported by the fact that only 16% of people in Serbia have acquired tertiary education (European Commission 2019, 30). Creating a knowledge based society and economy would be impossible without persons who would drive the development. This is even more so taking into consideration the rapid advances in technology that have already changed the way of doing business and introduced new required skills (Fitzpayne, Pollack 2018, 1; York 2019). Tuitions for further studies abroad can be especially very high and unattainable for students, but significantly beneficial due to the resources and opportunities offered by studying the latest achievements in the relevant field. Employers are in demand of such highly skilled workers and only by supporting their development can they both prosper.

The incentive proposed in this paper would require changes to the Law on Personal Income Tax and the Law on Corporate Income Tax.

It is proposed that if an employer covers the cost of a training or a course for a future employees, the total amount invested should be deductible from the employer's corporate income tax base as an expenditure, during the period in which the investment was made. Further, the benefit provided to the future employee would be exempted from personal income tax, i.e. the other tax, and it would not give rise to social security contributions. If the employer does not have enough taxable income from which it could deduct the whole amount invested, the right to carry over the remaining part of the investment would be allowed for up to five years.

To benefit from the incentive, it is necessary that the individual signs a contract with the future employer in which they would commit to working for the legal entity that covered the course cost, for at least two years. If the individual does not sign an employment agreement with the legal entity after the completion of the course, or terminates the employment voluntarily before the two years period has expired, they will be obliged to repay the total cost to the legal entity and to pay the personal income tax, i.e. the other tax, for the whole amount obtained.

The legal entity must be a tax resident of the Republic of Serbia in order to benefit from the incentive. Furthermore, the right of the individuals to apply for funding from their employer has to be available to all individuals who satisfy the requirements posed. The legal entity will decide whether it wishes to fund the specific course according to its business needs.

The qualifying training or education courses have to be work related, i.e. in the interest of the business activity performed by the legal

entity, otherwise, the incentive will not be applicable. The training or education course has to be related to the activities that the legal entity performs as its business activity. If the course is directed at obtaining personal gain for the employee but is not related to legal entity's business needs, the costs will not be deductible (such as obtaining a driving license if the job does not require it). Costs of obtaining another professional vocation (e.g. a secretary taking a course to become an accountant) will not fall into the category of qualified courses if it is of no use to the legal entity.

Costs that can be deducted are:

- the actual course cost (course fee),
- the costs of course materials such as specialised literature,
- daily allowance, if provided by the legal entity,
- travel costs, if provided by the legal entity,
- accommodation costs, if provided by the legal entity.

The maximum amount of the costs that the legal entity can deduct in one fiscal year is not capped. Namely, the incentive provides benefits for both parties, the legal entity and the individual, but it also provides a benefit for the Republic of Serbia. More highly educated and specialised workers will lead to the increase in the number of tertiary educated and highly specialised workers in Serbia, which would help economic development.

As specifically provided in Article 2 para. 4(3) of the Bylaw¹⁵ for applying the double deduction of R&D costs, according to Article 22g of the Law on Corporate Income Tax the costs for training of employees, and consequently of future employees, cannot be deducted in a double amount. This limitation provides a safeguard against eventual abuses of the incentive, while allowing the improvement of the current situation.

3. CONCLUSION

The importance of human capital, especially of the highly skilled individuals, has never been as important for the development of economies as it is in today's rapid technological advancements. Mobility of people, which has been constantly increasing, has speed up in the recent decades.

¹⁵ Pravilnik o uslovima i načinu ostvarivanja prava na priznavanje troškova koji su neposredno povezani sa istraživanjem i razvojem u poreskom bilansu u dvostruko uvećanom iznosu [Bylaw on the conditions and the method for exercising the right of recognition of expenditures directly related to research and development in the tax balance sheet in a double amount], *Official Gazette of the Republic of Serbia*, 50/2019.

People, especially the highly skilled ones, are more inclined to leave their home countries, homes and families in the search of a better life. There are many reasons why individuals leave their homes, but the most common one is the need for better economic conditions.

This trend has posed problems for countries which are losing the talents that could help them grow. Such a problem is especially grave for developing countries when they have to compete with developed countries for talents. However, developing countries have realised that they need to fight back and various incentives have been offered. One type of these incentives are tax incentives, as studies have showed that taxation plays a role in the decision for emigration.

The Republic of Serbia is the talent exporting country facing the problem of brain drain. According to the available statistics, the brain drain is not reducing, which demands a response from the government, in providing better living and working conditions. For that reason, the Government is at the moment proposing a set of tax incentives for reducing the tax burden of highly skilled workers. These incentives have been drafted following existing incentives in other countries, benefiting from their experiences. The incentives that are proposed are a 70% deduction of salary tax for new residents, the step up in basis for capital gains tax for new residents, the tax exemption for salaries of employees-founders of start-ups, the tax exemption for new employees and the tax exemption for the foreign source income of non-residents.

Furthermore, this paper proposes an additional tax incentive, which is proposed in order to promote investing in the education and skills of individuals, i.e. of future employees, willing to work on their professional development. Legal entities are encouraged to invest in the education and specialisation of future employees, by allowing them to deduct the entire amount invested in the training or education of future employees. Incentive is open for courses that are related to the business activity of the legal entity covering the course cost. This incentive is meant to increase the human capital stock in the Republic of Serbia, to increase the number of tertiary educated people who could lead the development of the country.

All of these proposed tax incentives should have a positive impact on the reduction of the brain drain in the Republic of Serbia, which is posing a threat to the country's development. Attracting and retaining highly skilled individuals, which will come at a cost in the form of reduced tax revenues in the short term, should help innovation and economy grow in the long term, through the activities of highly skilled individuals performed in the country. For that reason, steps undertaken by the Government of the Republic of Serbia can be seen as a step in the right direction for improving the country's prospects.

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