Overview of taxes, business enivornment and tariffs in Hungary, Serbia and Croatia

All three countries share similar tax environment and regulations: all have VAT and income tax and social contributions are witheld by the employer. However, tax rates differ, as well as the efficiency of the tax authorities. For a company that is labour intensive and exports outside of the region, labour tax and VAT rates are the most important ones to determine its most efficient investment location. Labour and VAT tax rates are more favourable to business in Serbia, but its tax authorities are known to be slow, inefficient, and partial in dealings with tax payers. However, the business environment in Serbian free trade zones provide a very competitive framework for doing business, since there are mostly none import taxes such as the VAT and tariffs.

Tax Overview

Tax regulations in Serbia, Hungary and Croatia follow international standards, so their main characteristics are similar: taxes are paid only on income derived form actiivites in Hungary, the fiscal year is from January to December, tax residence is determined by the fact if the natural person has resided more than 183 day in the country within a year etc.

The tax enviroment can be estimated through the total tax burden, as well as through the quality of tax administration. The Doing Business Report of the World Bank tries to qualify tax system to a certain extent through its Paying Taxes indicator. This indicator measures what is the time, number of payments, total tax rate (calculated as total taxes paid in comparison to gained profits) necessary for a local medium size enterprise to pay all taxes and to comply with postfiling process.

The constructed Quality Index is based on the total time needed to comply with the VAT refund procedure, time to obtain the VAT refund, time to comply with the corporate income tax audit and complete a corporate income tax audit.

Paying Taxes WB	OECD high income	Hungary	Croatia	Serbia
Rank	-	93.	95.	82.
DTF score	83.1	71.5	79.0	73.6
No of payments	-	11	35	33
Time in hours	-	277	206	225.5
Total tax rate	-	46.5%	20.6%	39.7%
Postfiling Index	83.5	63.9	62.2	91.1

DTF score = dinstance to fronetier measured to the best performing economy;

However, since all companies have professional financial and accountant service, these regulations can be troubling but are not the most burdensome. For companies that would engage in production for exports, the most burdensome tax regulations would be those on VAT refund and the total time necessary to receive those funds back. In this regard, Croatia outperforms by a high margin both Serbia and Hungary, that have almost identical results.

There is currently a delay in VAT refunds in Serbia, which is the consequence of the new and supposedly temporary policy of tax authorities to audit VAT refunds in the country more thoroughly, due to allegations of misconduct. There are data that many companies would close down in a couple of days after they received the VAT refunds, and that would open at a later date again, which raised red flags for some possible misconduct on a wider scale. This policy has extended the VAT refund from 8.2 in 2015/2016 to the current 14.7 in 2016/2017; however, there is a high probability that VAT refunds in the future would turn back to its previous level.

	Hungary	Croatia	Serbia
Time to receive VAT refunds – in weeks	15.2	6.2	14.7

From the point of labour costs, Serbia provides a more suitable destination for investments that are labour intensive. Not only are wages in Serbia significantly lower than those in Hungary and Croatia, but labour taxation (through both income tax and social security contributions) is less burdensome. For example, when calculated on an average salary, for every worker paid in Hungary or Croatia - almost two workers can be hired in Serbia.

	Hungary	Croatia	Serbia
Average net wage	657	800	396
Average gross wage	988	1093	546
Total labour costs	1220	1281	644

Net wage = money taken home by an employee; Gross wage = wage from the contract, including income tax and social security contributions paid by the employee; Total labour costs = gross wages plus social security contributions paid by the employer

When sales tax is taken into accounts, all three countries have a VAT tax system, although with different rates. VAT is applied to all goods and services, and afterwards it is refunded for VAT sources that were paid by suppliers on intermediate goods, or in full if the products are exported. Regular VAT rates in all countries are applied to the vast majority of products, while preferential rate(s) is applied to a limited number of products classifeid as necessities, such as basic foodstuffs, medicine or publishing. The EU VAT regulation has somewhat harmonized VAT rates across Europe, making an obligatory span for VAT rates, with the minimum of 5% and the maximum of 25%. Hungary, however, introduced the 27% VAT rate after the recession that followed the financial crisis in 2009 as a temporary measure, but still continues to apply it. Theoretically, Hungary should decrease the VAT rate below the upper EU threshold, but there are no information if and when this move could take place. VAT rates are also more favourable to entrepreneurial activities in Serbia, than in Croatia or Hungary.

	Hungary	Croatia	Serbia
Preferential VAT rate	18% (and 5%)	13% (and 5%)	10%
Regular VAT rate	27%	25%	20%

Corporate tax rates in all three countries are very favourable when compared to OECD countries, but Hungary and Serbia beat Croatia in this measure. Croatia has, therefore, recently introduced changes in corporate tax regime, in order to allign its tax rate more with its regional peers, lowering its tax rate for 2 percentage points and introducing a significantly lower tax bracket for small companies. But even after these changes, its corporate tax regime remains less attractive than those of Serbia and Hungary.

	Hungary	Croatia	Serbia
Corporate tax rate	9%	18%	10%
Special tax rate	-	12%	-

Other taxes and surcharges can also be numerous, but they are less generous than the above mentioned VAT, corporate or income tax and social security contributions. These smaller taxes and surcharges strongly differ between countries, and also divided between the central and local government. The most important ones for majority of businesses is the property tax, an important source of income for local government in all three countries, while the most important tax for new business ventures is the one off transfer tax for purchase of land and real estate.

	Hungary	Croatia	Serbia
Transfer tax	4%	4%	2.5%
Property tax	3% for land; 3.6% for buildings	-	0.3 – 0.4%

The system of parafiscal surcharges in Serbia is still not well regulated – there are hundreds of small surcharges on the central government and local level. There is not even an official list of them, which decreases business predictability. However, the new Law on taxes and surcharges in Serbia is being written, supported by the IMF, and it is expected to eliminate the possibility of easy introduction of new local surcharges and to make the system more predictable.

An important caveat regarding the uneven quality of tax authorities in different areas of the country should be taken into account, since the recent World Bank study (Doing Business in the European Union 2017: Bulgaria, Hungary and Romania) showed that there can be a high level of variation in the local administrative quality, although the study did not cover Paying Taxes section. In Serbia, tax authorities are divided between the central and local government – the central government tax authorities are under the Ministry of Finance and it controls the most important taxes. The Ministry has dispersed tax authority branch offices across the country, covering smaller administrative areas. Apart from that, local government (municipalities and towns) have their own local tax authorities which are in charge of smaller local taxes. Therefore, it is possible that administrative capacities differ not only in the case of local tax authorities, but also between local branches of the central tax authorities.

Import Taxes

Import taxes are those paid on consumption of imported goods. The most important ones are the VAT (which is also applied to domestically produced goods) and tariffs (applied only to imported goods). In most countries where VAT is used, the destination principle is applied, which has a strong impact on international trade due to the different VAT levels. The principle of destination means that VAT should be paid in the jurisdiction where the god is consumed – in the case of goods that are exported, VAT is paid in the importing country. However, the VAT is also paid in the country where it is produced and then the funds are refunded after the exports. This can pose significant constraints and costs for companies since they have to wait to receive their money back, which can pose liquidity problems and demand external bank financing for that period. As a rule, in all three countries the VAT is paid at the customs for the imported goods, and then these funds are refunded after its exports.

However, Serbia provides a good exception from this case in the specific situation of free trade zones, since rule applied for companies operating in these zones are different from the rest of the countries. There are three different scenarios regarding import taxes:

(1) A company imports some goods from abroad and exports the final products outside the EU.

In this case no VAT or tariffs are applied, upon imports or otherwise. The imports are completely tax free. The importer, of course, needs to pay any tariffs, sales tax or VAT applied in the country of destination.

(2) A company imports some goods from abroad and exports the final products to the EU.

If products are exported to the EU, VAT and tariff are applied partially only on those parts of the product that were imported from third countries (i.e. not from the EU or Serbia). For example, if the company assembles vehicles and it uses wheels imported from China and sells them in Germany, it pays VAT and tariffs only for those wheels and not on the whole product.

(3) A company imports some goods from abroad, and sells the products in Serbia.

In this case, there are no tariffs or VAT upon imports and entrance of the goods into the free trade zone. However, when the products leave the free trade zone to enter the rest of the country, both tariffs and VAT rates are applied.

(4) A company imports some goods from Serbia and sells the products abroad.

Since the VAT is already part of the price, the company pays the VAT but can file for a VAT refund after the exports. The legal timeframe for VAT refund is 15 days for companies that are predominantly exporters, and 45 days for the rest, but in some cases this has been recently prolonged. However, building services within the free trade zone and electricity consumption is Vat free, at least for now since the EU demands these benefits to be revoked since they are not in line with the EU regulations.

Destination Import Tariffs

Serbia is not a member of the World Trade Organization (WTO). Therefore, exports to countries that do not have a bilateral free trade agreement (FTA) with Serbia can be burdened with high tariffs, much higher than for the WTO member countries. Although Serbia has a number of FTAs for its most important trade partners – the EU (SAA), the Western Balkans (CEFTA), the Russian Federation and Turkey, many other countries from other continents remain yet to be covered through this trade facilitation process.

In the case of the refrigerators (Harmonized System Code 2017: 8418.10) and selected countries from the Latin America or Africa, the data show that the situation is rather heterogeneous. In the case of Mexico, refrigerators imported from Serbia and the EU face the same tariff rate of 12.5%; in the case of the Dominican Republic the tariff is higher while in the case of Kenya it is lower for Serbian products.

Country	Serbia	European Union
Mexico	12.5%	12.5%
Dominican Republic	25%	20%
Kenya	20%	25%

MFN applied tariff rate to imported HSC 8418.10 products from selected countries

This would imply that reallocation of a company producing refrigerators and exporting them to these three countries from Hungary to Serbia would not pose a burden in the form of increased tariffs on its products, since only one target market (the Dominican Republic) would increase its tariff, and only for 5 percentage points, while one would even decrease it (Kenya).

Case study

A hypothetical example could do well to illustrate the potential attractiveness of the tax regime in Serbia, Hungary and Croatia. The case study regards a processing company that employs 50 workers on an average salary, makes 25 million euros in exports with a 10% revenue margin. Wage and VAT expenses (calculated as monetary costs of the VAT payables, which are paid and afterwards refunded, with predominant bank interest rate on liquidity loans in the country: Hungary 3.22%, Croatia 3.62%, whule in Serbia this would be 2.92% but the VAT would not be applied if the company operates in the free trade zone and exports out of the EU) and corporate taxes are considered as the main expenses of the enteprise.

	Hungary	Croatia	Serbia
1 Revenue margin	2 500 000	2 500 000	2 500 000
2 VAT payable	6 750 000	6 250 000	0
3 VAT expenses (2*interest rate*duration)	63 000	28 000	0
4 Wages expenditures	732 000	768 600	386 400
5 Total expenses (3+4)	794 000	796 000	386 400
6 Gross earnings (1-5)	1 706 000	1 704 000	2 113 600
7 Corporate tax (6*tax rate)	153 540	306 720	211 360
8 Net earnings (6-7)	1 552 460	1 397 280	1 902 240
9 Net earnings as % of the margin	62.1%	55.9%	76.1%

The table illustrates that the biggest profits under the same circumstances can be achieved in Serbia, followed by Hungary and with Croatia at the end of the list. Serbia provides almost twice the profits that could be expected in Croatia, and more than a hlaf of it expected in Hungary. Serbian business environment is more suitable for the enterprise from this case study due to: (1) lower wages expenses (because of the lower level of wages but also lower labour tax and social security contributions), (2) lower VAT expenses (since the VAT is not applied if a company is operating within a free trade zone and it exports outside of the EU), and (3) low corporate tax rate. In the case study above, the desribed company would have acquired more than 500 000 EMU or almost a third more profit on an annual basis if operating in Serbia, than in Hungary. Numbers for Croatia are even less promising.