

CROSS-CHECKING OF INCOME TAX RETURNS WITH WORTH ACCRETION: SERBIA'S LEGISLATION IN THE COMPARATIVE LAW CONTEXT

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Summary

In the paper Serbia's Law on Determining the Origin of Property and the Special Tax is analysed and compared with solutions based on cross-checking of the declared income with the worth accretion, which can be found in comparative tax law. After having established the advantages and limits of the net worth method, the author presents this Serbian statute, pointing out the fact that significant resources have been allocated for its application. The explanation lies in its PR impact and the possibility that detected unreported income of those who are the Government's political opponents could be taxed at a rate of 75%. Net worth method has been present in another Serbian statute since 2003, but it was not applied due to the absence of political will. However, this provision remains in the system, providing for dualism since 2021 – one group of taxpayers is subject to the old regime (with 20% tax), while the others are exposed to new confiscatory 75% tax. The analysis shows that numerous provisions of the 2021 statute contradict constitutional provisions on the unity of legal order, non-discrimination, legality of taxes, and prohibition of retroactivity. Provided these flaws are eliminated, the application of net worth method could make sense.

Keywords: net worth method; unreported income; worth accretion; unity of legal order; confiscatory tax.

1 INTRODUCTION

The recent entering into force of Serbia's Law on Determining the Origin of Property and the Special Tax¹ has initiated a debate on whether the Statute's good side overwhelms its weaknesses, as well as whether it requires a theoretical and comparative law investigation of the mechanism introduced by this piece of legislation. The expectations from it are twofold. On the one hand, during the 1990s and in the

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1 Official Gazette of the RS, nos. 18/2020, 18/2021 (hereafter: LDOP&ST).

post-Milošević era, a number of Serbia's nationals made fortunes through opaque transition processes and large-scale tax evasion, and widespread expectations still exist that justice must be served – both in the domains of criminal law and taxation. On the other hand, the present Government, which has been in power since 2012, is trying to demonstrate that it is following *vox populi*, with the side effect being that taxing primarily “assets acquired in an unlawful manner” by its political opponents² could generate a significant public relations effect (positive for the Government, adverse for the opposition), while causing material harm to the latter if caught in the “grip of the law”. The tool chosen by Serbia's Government is based on cross-checking the worth accretion of selected natural persons with their declared income. The goal of this article is to examine the theoretical foundations of such an approach, its presence in comparative tax law, and the deeper layers of the established statutory framework in order to test the constitutionality of certain statutory provisions.

The paper is organised in the following manner. The concept of the “best judgment” tax assessment is dealt with in Section 2. Section 3 is dedicated to the analysis of the “net worth” method, which underlies the cross-checking of the income tax returns with the worth accretion, as introduced by the LDOP&ST. Section 4 considers the main features of the procedure for the determination of the origin of a taxpayer's property and examines whether certain provisions of the Law go against Serbia's Constitution³ and certain internationally approved best practices. Section 5 is dedicated to the specificities of the judicial reviewing in this matter. In Section 6 the LDOP&ST's relation with the existing provisions of Serbia's Law on Tax Procedure and Tax Administration⁴ is dealt with. The paper ends with the Concluding Remarks.

2 “BEST JUDGMENT” TAX ASSESSMENTS

The numerous classifications of taxes are based on the selected *criterion divisionis*.⁵ If the mode of determining the taxable base is chosen, one can distinguish factual from presumptive taxes. In the case of factual taxes, the taxable base is determined in accordance with the actually generated taxable event (income, property or transaction). In the case of presumptive taxes, the taxable base is determined based on the presumption that a taxpayer realised, or could have realised, revenue of a certain size. The tax authorities rely on the presumptive taxes in two situations.

The first situation may be described as a “hard-to-tax” one and is based on assessing the “estimated income”. It should be noted that the assessment of the

2 The law is naturally general in its character. It is, however, revealing that the Secretary of State with the Ministry of Justice, Radomir Ilić, while presenting the draft of that piece of legislation on the public service TV, on 29 January 2019, used the examples of two opposition leaders to explain how the law would function, <https://www.youtube.com/watch?v=Rq9O5aVm2Dc>, accessed 8 June 2021.

3 Constitution of the Republic of Serbia, Official Gazette of the RS, no. 98/2006.

4 Official Gazette of the RS, nos. 80/2002, 144/2020 (hereafter: LTPTA).

5 Dejan Popović, *Poresko pravo* (Beograd: Pravni fakultet Univerziteta u Beogradu, 2020), 88 *et seq.*

estimated income is not conducted because the taxpayer failed to disclose the full income. Namely, the tax authorities apply the assessment of the estimated income because the determination of the actual income would be impossible or entail serious obstacles, the removal of which would incur excessive costs. The variety of taxes levied on the estimated income in contemporary tax systems (often known as *Pauschalsteuern* in German) is presented by Pashev.⁶

The second situation occurs when the taxpayer fails to file a tax return despite the statutory obligation to do so, or when the return has been filed but contains the data that the tax authorities have reason to consider inaccurate. In such case the tax authorities are entitled to resort to the “best judgment” assessments.⁷ In Serbia’s tax law literature this approach has been called “*ex officio* determination”⁸ and Section V of the *French Livre des procédures fiscales*⁹ denominates it as “*taxation d’office*”. Unlike estimated income approach, the best judgment assessment does not represent a substitution for actual income but an approximation of it.

The legal authority to make best judgment in some countries is provided in the general statutory terms. For example, pursuant to § 6201 of the U.S. Internal Revenue Code,¹⁰ the assessing officer is authorised and required to make the inquiries, determinations, and assessments of all taxes, while § 6204 specifies that the officer may, at any time within the period prescribed for assessment, make a supplemental assessment whenever it is ascertained that any assessment is imperfect or incomplete in any material respect. On the other hand, there are tax law systems in which the assessing officer is entitled to base the assessment on fairly vague, but in a way indicated, considerations. In Serbia, Art. 58a of the LTPTA provides for an alternative application of three “parification” methods: (1) assessment based on available regular records covering business operations in a specified period (day, week, month) shorter than the taxable period; (2) assessment based on data and facts on turnover; (3) comparison with the data on other taxpayers carrying out the same or similar activities, at the same or similar location, under approximately equal conditions. In Argentina, Art. 18 (1) of *Procedimiento para la aplicación, percepción y fiscalización de impuestos*¹¹ specifies the following indications: the capital invested in the operation, the fluctuations in assets, the volume of transactions and profits of other tax periods, the amount of purchases and sales, the normal yield of the business or operation or of similar enterprises, etc. In some countries a minimum tax approach is followed,

6 Konstantin Pashev, “Presumptive Taxation and Gray Economy: Lessons from Bulgaria”, *Center for the Study of Democracy Working Paper* 0512, no. 1 (2005): 6 *et seq.*

7 Arye Lapidot, *The Use of Estimation for the Assessment of Taxable Business Income* (Amsterdam: International Bureau of Fiscal Documentation, 1977), 13.

8 Popović, *Poresko pravo*, 95.

9 *French Livre des procédures fiscales* <https://www.legifrance.gouv.fr/codes/id/LEGITEXT000006069583>, accessed 10 May 2021.

10 U.S. Internal Revenue Code <https://www.law.cornell.edu/uscode/text/26/6201>, accessed 10 May 2021.

11 *Ley 11.683 (texto ordenado en 1998 y sus modificaciones)*, accessed 6 May 2021, https://archivo.consejo.org.ar/Bib_elect/mayo03_CT/documentos/L11683.htm.

based on a fixed percentage of the business assets.¹² Some legislations rely on the presumption that the taxable business income can be no less than a specified percentage of the gross receipts.¹³ A number of other methods, mainly not aimed at reconstruction of income (and therefore also linkable to the assessment of the estimated income), can also be found elsewhere in the world.¹⁴

However, the best judgment assessments may be based also on “more sophisticated techniques of estimation”¹⁵ than those embodied in abovementioned methods of “parification”. A quite widespread method for the best judgment assessment is to estimate income by determining the change in the taxpayer’s net worth over the year, while adding to this amount the estimated personal consumption expenses.¹⁶ This procedure is called the net worth method. Its denomination in Serbia’s tax law is “cross-estimation of the taxable base”.¹⁷

3 NET WORTH METHOD

The basic assumption underlying the net worth method is the accretion theory of income (German: *Reinvermögenszugangstheorie*) as developed (independently from each other) by Schanz,¹⁸ Haig,¹⁹ and Simons.²⁰ Income (I) is defined as the sum of a taxpayer’s personal consumption expenses (C) and the change in his/her net worth (∂W) in the given period. If the net worth at the beginning of a taxable year (on 1 January)²¹ is W_1 and on the 31 December W_2 , ∂W is equal the difference between W_2 and W_1 and the income is represented by the equation:

$$I = (W_2 - W_1) + C. \quad (1)$$

It should be noted that income can be reported (I_r) and unreported (I_u), which provides the tax authorities with the starting equations for the application of the net worth method:

$$I_u = I - I_r. \quad (2)$$

12 For example, in Argentina, prior to 2019, a 1% tax on the value of fixed and current assets existed as a tax on minimum notional income. *Ministerio de Hacienda, Secretaría de Ingresos Públicos*, “The Tax System in Argentina”, 1, accessed 6 May 2021, www.argentina.gob.ar/s.../tax_system_in_argentina.pdf.

13 Charles E. McLure, Jr. *et al.*, *The Taxation of Income from Business and Capital in Colombia* (Durham, NC: Duke University Press, 1990), 144–145.

14 Victor Thuronyi, “Presumptive Taxation”, in: *Tax Law Design and Drafting*, Vol. 1, ed. Victor Thuronyi (Washington, D. C.: International Monetary Fund, 1996), 410 *et seq.*

15 Lapidoth, *The Use of Estimation*, 104.

16 Thuronyi, *Presumptive Taxation*, 408.

17 Art. 59 of the LTPTA.

18 Georg Schanz, “Der Einkommensbegriff und die Einkommensteuergesetze“, *Finanz-Archiv* 13, no. 1 (1896): 1–87.

19 Robert Murray Haig, “The Concept of Income – Economic and Legal Aspects”, in: *The Federal Income Tax*, ed. Robert Murray Haig (New York, NY: Columbia University Press, 1921), 27.

20 Henry C. Simons, *Personal Income Taxation. The Definition of Income as a Problem of Fiscal Policy* (Chicago, IL: The University of Chicago Press, 1938), 50.

21 Or at the beginning of the control period within the calendar year.

$$I_u = (W_2 - W_1) + C - I_r \quad (3)$$

A fully fledged net worth method has to include several more parameters. Namely, the difference between $[(W_2 - W_1) + C]$, on the one hand, and I_r , on the other, has to be diminished (in other words: the subtrahend has to be increased) by the value of gifts, bequests, and similar items (G) and assets acquired by borrowing (B), the latter parameter serving to ensure that this is all about *net* worth. Thus, the unreported income equals:

$$I_u = [(W_2 - W_1) + C] - (I_r + G + B). \quad (4)$$

In all countries relying on this approach to the best judgment, assessments equation (4) represents the core of the applied procedure. In a number of tax law systems this has been specified in the respective statute: e.g., in Colombia in Art. 236 of *Estatuto Tributario*,²² in Serbia in Art. 59 of the LTPTA, and in India in Articles 68–69D of the Income Tax Act.²³ In other countries the authority to carry out the net worth method is granted indirectly through the general empowerment contained within *taxation d’office* approach (like in Articles L66–L72A of the French *Livre des procédures fiscales*, Articles 145 (a) (2) (b) and 145 (b) of the Israeli Income Tax Ordinance²⁴ or § 6204 of the U.S. Internal Revenue Code).

Since the net worth method is aimed at reconstructing the entire taxable base, the taxpayers are usually given the right to rebut the estimate obtained by cross-checking of the income tax returns with the worth accretion. It should be noted that the increased net worth is not taxed *per se* but only insofar as the actual income has not been reported.²⁵ Taxpayers may rebut the presumption of concealed taxable income which caused the accretion of net worth by furnishing evidence that the increase of their net worth “owes its origin to any source whatever of non-taxable income.”²⁶

Apart from attempting to prove the role of bequests and gifts in the increase in net worth, the taxpayers would, as may be expected, focus on the personal consumption expenses, which are arguably the most rebuttable. Although certain expenses of this kind are verifiable (mortgage, rent, utilities, alimony, etc.), others are difficult to prove (entertainment, holidays, restaurants, foodstuff, etc.). Hence there are tax law systems (like in Colombia²⁷) where personal consumption expenses are simply excluded by the legislator’s decision, implying that the unreported income is defined as the increase in net worth reduced by reported income and exempted receipts. The assumption that personal consumption expenses are zero is favourable for the taxpayers, bearing in mind that a significant fraction of income is consumed. In a number of tax law systems this assumption does not exist and the best judgment encompasses also

22 *Decreto 624 (texto ordenado en 1989 y sus modificaciones)*, accessed 7 May 2021, <https://estatuto.co/?e=995>.

23 Income Tax Act <https://www.incometaxindia.gov.in/pages/acts/income-tax-act.aspx>, accessed 7 May 2021.

24 Income Tax Ordinance https://www.icnl.org/research/library/israel_ordinance/, accessed 8 May 2021.

25 Lapidoth, *The Use of Estimation*, 104.

26 Lapidoth, *The Use of Estimation*, 104.

27 Art. 236 of Colombia’s *Estatuto Tributario*; Art. 59 (1) of Serbia’s LTPTA.

personal consumption expenses. Lapidoth pointed out that estimating the taxpayer's "living expenditure" in Israel often involved "long and tedious examinations and cross-examination of witnesses,"²⁸ both within the administrative and the judicial procedure.

A strange dualism may be found in Serbia's tax law where two pieces of legislation are concurrently regulating the net worth method. While the "standard" net worth method, as prescribed by Art. 59 of the LTPTA (in force since 2003), fails to take into account consumption, since the legislator was aware that it would be difficult to prove these expenses, the recently effectuated LDOP&ST indirectly includes personal consumption expenses. Namely, the provision of its Art. 11 (2) has delegated to the Regulation on Means and Procedure of Determining the Value of Assets and Income of a Natural Person and the Expenses for the Private Needs of a Natural Person²⁹ (hereafter: Regulation) the authority to prescribe how to value these expenses. However, since the LDOP&ST has neither regulated the position of the personal consumption expenses within the net worth method, nor provided a definition of income in the sense of the Schanz–Haig–Simons concept (which, if given, could have posited these expenses), it was left to Art. 31 (1) of the Regulation to stipulate the role of the personal consumption expenses in the application of this method. In doing so the Regulation has overstepped the framework given to bylaws in the tax law, according to Art. 91 (1) of Serbia's Constitution, which proclaims that taxes (i.e. all basic elements of the legal definition of a tax) must be introduced by statutes. The taxable base – one of these basic elements – of the "special tax" (introduced by the LDOP&ST), to be levied after the net worth method has been applied, does contain personal consumption expenses. However, they have been posited in the taxable base correctly (as an addend in equation (4) and not as, for example, a subtrahend), but in a manner that infringes the principle of legality in tax law, since they have been introduced via a sub-statutory regulation and not by a statute.

The statute of limitation can also trigger the problems with the application of the net worth method. There are two ways to bypass them and prevent the taxpayer from avoiding the tax altogether. The first one is to stipulate in the law that *lex generalis*, with respect to the statute of limitation, shall not be applicable. This is the approach followed, for example, in Serbia (Art. 18 (1) of the LDOP&ST). The second one, suggested by Lapidoth,³⁰ is to prescribe in the statute that an unexplained increase of net worth should be taxed in the year in which it was discovered rather than in the year in which it actually accrued.

Another issue arises when a new levy, rather than the income tax, is introduced on unreported income discovered using the net worth method. This is the case with Serbia's "special tax" introduced by the LDOP&ST. The new levy on income realised prior to its entering into force is retroactive and Art. 197 (1) of the Constitution in principle does not allow retroactivity of statutes and other general legal acts. However, Art. 197 (2) of the Constitution exceptionally allows that certain statutory provisions

28 Lapidoth, *The Use of Estimation*, 113.

29 Official Gazette of the RS, no. 23/2021.

30 Lapidoth, *The Use of Estimation*, 104–105.

may have a retroactive effect, if so required by general public interest, as established in the procedure of adopting the statute. The minutes of the parliamentary procedure show that a general public interest that the provisions on the “special tax” should be retroactive was not established in the course of the process of enactment of the LDOP&ST. In order to avoid a dispute before the Constitutional Court, which may lead to the annulment of the provisions on the “special tax”, due to their retroactivity, the legislator opted to denominate the taxable base (I_u) as “property” rather than “income”. Namely, the Constitutional Court decided in a 2002 ruling that in the cases of property taxation the retroactivity cannot be invoked since “such taxes are always levied on the property which existed in the moment of taxation, and it is in the nature of things that it was previously acquired.”³¹ It is yet to be seen whether the incorrect denomination of the taxable base could prevent the detection of retroactivity that violates the Constitutional provisions.³² That it is a matter of incorrect denomination was for the first time pointed out 44 years ago, to the author’s knowledge. “Although people sometimes refer to the ‘the taxation of unexplained capital,’ it should be regarded as a figure of speech only. The increased capital is never taxed *per se*. At the most, it may be indicative of some undisclosed taxable income.”³³ Serbia’s “special tax” should therefore be classified as a tax on unreported income rather than a levy on property (capital).

4 THE PROCEDURAL ISSUES

4.1 The Responsible State Body

Pursuant to Art. 4 of the LDOP&ST, the application of the net worth method and the assessment and collection of the “special tax” are conducted *ex officio* by a special Unit within the Tax Administration (hereafter: Unit). Taking into account none of the results whatsoever of the application of the “standard” net worth method, as stipulated by Art. 59 of the LTPTA since its entering into force in 2003, the establishment of the Unit may be seen as an indication that additional resources have been allocated in order to facilitate discovering of undisclosed income of certain “important” natural persons, potential large tax evaders. However, it is yet to be seen whether such reallocation of the scarce resources that are at the disposal of the Tax Administration (hereafter: TA) will have an adverse impact on how its other functions are carried out.

Furthermore, the legislators decided to expand the resources to be available to the Unit by imposing several obligations on a number of government bodies, as well as on independent entities. Apart from prescribing that all public bodies, natural

31 Decision on the Assessment of Constitutionality and Legality of the Law on One-off Tax on Extra Income and Extra Property Acquired by Drawing Special Advantages, Official Gazette of the FRY, no. 17/2002; Official Gazette of the RS, no. 18/2002. All quotes of texts originally in Serbian language have been translated into English by the author.

32 The “standard” net worth method, prescribed by Art. 59 of the LTPTA, is not exposed to an unconstitutionality challenge since the discovered undisclosed income is subject to the established personal income tax rather than to a “special levy” with retroactive effect.

33 Lapidoth, *The Use of Estimation*, 111.

persons and legal entities are required, upon the Unit's request, to forward data at their disposal and provide support to the Unit's officials in conducting the procedure, the LDOP&ST stipulates that not only ministries and public agencies, but also the National Bank of Serbia, and the Central Securities Depository and Clearing House (hereafter: CSD) are required to assign one or more of their employees as liaison officers with the Unit. Art. 8 (2), (3) of the LDOP&ST envisages that these liaison officers are to be temporarily ("up to a year, with the possibility of extension") transferred or seconded to work in the Unit upon the request of the Director of the TA. The non-consensual temporary secondments of non-governmental employees to the Unit raises serious constitutional issues.³⁴ Namely, with respect to the employees in the National Bank and the CSD, the provisions of Art. 8 (2), (3) of the LDOP&ST contradict provisions of the Law on the National Bank³⁵ and the Law on the Capital Market.³⁶ The rights and duties of the employees are, pursuant to Art. 83 of the LNB, regulated by the Law on Labour.³⁷ Art. 174 (1) of the LL protects an employee against non-consensual temporary secondment to another employer by limiting it only to the cases where the need for his/her work has temporarily ceased, where the business premises have been let, or where an agreement on business cooperation has been concluded – for the duration of these reasons but not longer than a year. Pursuant to Art. 219 of the LCM, the same provisions of the LL apply to the employees of the CSD. The Constitutional Court of Serbia on several occasions established that "the constitutional principle of the unity of the legal order dictates that the fundamental principles and legal institutes envisaged by the laws, which in a systematic manner regulate a sphere of social relations, must be also honoured in specific laws, unless the systematic law explicitly provides for a possibility of different regulation of these issues."³⁸ Since the LL does not provide for any exception from the rule regulating the conditions for non-consensual temporary secondments to other employers, and the LNB and the LCM do not provide for a possibility of non-application of the LL to their respective employees, the constitutionality of the provisions of Art. 8 (2), (3) of the LDOP&ST may be challenged from the point of view of infringement of the constitutional principle of unity of the legal order.

4.2 The Subject-Matter of the Procedure

It is worth mentioning that the denomination of the procedure prescribed by the LDOP&ST is inconsistent. In the title of the Statute the syntagma "determination of the origin of property" is used, while its Art. 1 defines the subject-matter of the Law as "determination of property and increase of property". In spite of the former

34 Dejan Popović and Svetislav V. Kostić, "Predlozi i sugestije na Nacrt zakona o utvrđivanju porekla imovine i posebnom porezu", working document (Beograd: Srpsko fiskalno društvo, 2019), 10.

35 Official Gazette of the RS, nos. 72/2003, 44/2018 (hereafter: LNB).

36 Official Gazette of the RS, nos. 31/2011, 153/2020 (hereafter: LCM).

37 Official Gazette of the RS, nos. 24/2005, 95/2018 – other ordinance (hereafter: LL).

38 Constitutional Court, Decision IUz-231/2009 of 22 July 2010.

denomination, there is no provision in the LDOP&ST dealing with the origin of the net worth. Namely, a natural person may, in principle, acquire property in the following ways: (1) saving of income that he/she has declared to the TA in accordance with the Personal Income Tax Law³⁹ (e.g., capital gains, business income /provided that he/she keeps books/); (2) saving of income that he/she did not declare but the taxation of which was in the form of withholding (e.g., dividends distributed by a resident payer, or salaries paid by a resident employer);⁴⁰ (3) saving of income which he/she was required to declare, but did not comply with the statutory obligation; (4) through inheritance, gifts, or borrowing; (5) through theft, corruption, embezzlement, or similar criminal offence; (6) through a combination of these ways. But the LDOP&ST is silent in this respect. Art. 13 (2) the LDOP&ST actually targets the difference between the increase in property and *declared* income. The “origin of property” used in the title of the Statute serves only for propaganda purposes in an environment where the public is filled with expectations that (fiscal as well as general) justice must ultimately be served.

There is, however, a problem with the concept of “declared income” as used in Art. 13 (2) the LDOP&ST. As noted above, there are types of income subject only to withholding taxes and it is questionable whether the natural person included in the procedure prescribed by the LDOP&ST should be responsible for the omission of the withholding agent to report such income (and the tax supposed to be withheld) to the TA.⁴¹ The Government tried to overcome this problem through the sub-statutory Regulation, in which the “declaration of income” is defined widely, encompassing both the obligations of the recipient and the payer of income. The consequence of such an approach is that the responsibility for the payer’s omission to report the income *ex lege* subject to withholding tax is on the recipient – the natural person subject to the procedure established by the LDOP&ST.

To make a taxpayer liable for the omission of the withholding agent is not considered the best practice in current tax law systems. The Observatory on the Protection of Taxpayers’ Rights argues for the opposite.⁴² Just few national tax laws (e.g., the South African) contain a provision prescribing that the recipient should be responsible for the payer’s failure to withhold tax.⁴³ Serbia’s Regulation may be classified as belonging to these rare tax law systems. If the general procedural tax law – the LTPTA – is taken into consideration, the issues related to the application of the norm providing for the recipient’s liability, in the case of the withholding agent’s omission to fulfil its duty, only become aggravated. Namely, although Art. 12 (3) (2) of the

39 Official Gazette of the RS, nos. 24/2001, 153/2020 (hereafter: PITL).

40 Unless the taxpayer’s total annual income (excluding capital income) exceeds three times the average annual salary in Serbia, paid in the year for which the tax is determined, in which case he/she is subject to the complementary annual income tax and is required to file a tax return.

41 In addition, there are receipts excluded from income taxation that also contribute to the increase of the net worth. *Nota bene*, from a theoretical point of view, one cannot qualify inheritance, gifts or borrowing as “income”.

42 Observatory on the Protection of Taxpayers’ Rights, *The IBFD Yearbook on Taxpayers’ Rights 2019* (Amsterdam: International Bureau of Fiscal Documentation, 2020), 37, 38.

43 Observatory on the Protection of Taxpayers’ Rights, 38 f.

LTPTA requires that the resident payer apply withholding procedure whenever it pays certain types of income to the taxpayer, it is Art. 100a (3) of the PITL that imposes the obligation for a taxpayer (recipient of income) to self-assess the tax in the case where the payer failed to withhold it. The amendment that introduced such obligation entered into force on 1 January 2018,⁴⁴ but during the three and half years since the beginning of its effectiveness no data on the taxes (and compulsory social security contributions) collected under the above-mentioned circumstances has become available, so it is reasonable to conclude that the collection procedure stemming from the provision of Art. 100a (3) of the PITL has not been applied yet. Before analysing the reason why the TA has not applied this norm yet, it should be noted that Art. 30a of the LTPTA stipulates that a bank is authorised to allow the payment of income subject to withholding taxes to a natural person only if the payment order contains authorisation number issued by the TA upon the receipt of the tax return filed beforehand by the payer of the income. The fact that a significant number of employees eventually realise that their employers did not pay compulsory pension contributions⁴⁵ indicates that the TA is tolerant toward this type of tax evasion, applying volatile and arbitrary, sometimes politically motivated criteria for tacitly granting certain employers the “privilege” of paying salaries without withholding, in clear violation of the Law. It is in such an environment that the TA has been consistently failing to exercise its right to tax the recipient of income subject to withholding tax in cases where the payer failed to conduct the withholding procedure; it would be difficult to explain how it was possible to execute the payment at all, given the statutory obligations imposed on the payers, banks and the TA. However, the sword of initiation of tax execution hangs over the heads of mostly unaware employees and may strike at any time (the statute of limitation is five year).

Once the application of the LDOP&ST provisions commences, in the cases where the payers failed to withhold the tax, the treatment of a natural person subject to the net worth method and a recipient of salaries or other income under Art. 100a (3) of the PITL should be aligned. To consider the former responsible for the payer’s omission to withhold, while leaving the latter untaxed, represents discrimination, which is prohibited by Art. 21 of the Constitution.

4.3 The Procedural Stages

The procedure envisaged by the LDOP&ST is conducted in two phases: (1) preliminary proceedings; (2) audit and assessment of the “special tax”.

The preliminary proceedings can be initiated either based on risk analysis or upon the report of another body or initiative of a natural person or a legal entity. The room for the Unit’s manoeuvring with respect to sequencing the cases to be dealt with, as well as to the appropriateness of their initiation at all, is thus left wide. In the first

44 Art. 42 of the Law on Changes and Amendments to the Personal Income Tax Law, Official Gazette of the RS, no. 113/17.

45 Law on Changes and Amendments to the Personal Income Tax Law, <http://www.inspektor.gov.rs/page/260>, accessed 20 May 2021.

phase the Unit determines the increase in net worth, based on the available data and the data forwarded by other bodies and organisations, legal entities or natural persons, and cross-references them with the declared income. The Unit initiates the audit phase in the case of those natural persons for whom in the preliminary proceedings it has established as probable that within no more than three consecutive calendar years there has been a difference between the increase in net worth (personal consumption expenses being disregarded at this juncture) and declared income in excess of EUR 150,000.

Pursuant to Art. 3 of the LDOP&ST, the burden to prove the increase in the net worth in respect of the declared income is on the TA, but the bar is set rather low: the Unit is required only to “establish as probable” that there is a difference between the increase in net worth and the declared income.⁴⁶ On the other hand, the natural person has the task to “prove” the legality of the assets acquired in the domain where the increase of his/her property does not correspond with the declared income. However, the concept of “legality of acquiring” can be found nowhere in the LDOP&ST, and such omission raises a series of serious legal questions.

Relying on the definition of the phrase “property subject to the special tax” stated in Art. 2 (5), one can only indirectly conclude that legally acquired property could be property acquired from declared income augmented by non-taxable income, as well as property acquired by bequest, gift, borrowing or in other *lawful ways*. It should be pointed out that the usual meaning of the term “lawful way” does not always correspond to “legality of the property acquired” in the sense of the LDOP&ST, which the natural person is required to prove. For example, in the case where a resident natural person legally acquired dividend income from stock in a company that is a resident of Austria, whereby the payer applied the withholding tax at the rate of 15%, as prescribed by Art. 10 (2) (2) of the Double Taxation Treaty between Austria and Serbia,⁴⁷ but the natural person failed to file the tax return in accordance with Art. 100a (2) of the PITL, there is unlawfulness in the procedural sense, but without fiscal consequences for the budget of Serbia.⁴⁸ Namely, pursuant to Art. 24 (2) of the Double Taxation Treaty, Austria’s tax on dividends may be credited against the Serbia’s tax on capital income, whose rate is also 15%.⁴⁹

If one nevertheless follows the above-mentioned indirect (imprecise, but the only one available) conclusion on what “the legality of the property acquired” could be, the natural person subject to the tax audit in the second phase of the procedure prescribed by the LDOP&ST will be required to prove that the difference between $[(W_2 - W_1) + C]$ and $(I_r + G + B)$ in the equation (4) is zero – in other words, that there is no unreported income. The provision on the burden of proof does not include any indication (Art. 3 of the LDOP&ST) who should prove the amount of personal

46 Art. 116 (5) of the Law on the General Administrative Procedure, Official Gazette of the RS, nos. 18/2016, 95/2018, prescribes that an administrative matter may be decided based on facts that are probable only if it is envisaged by a law.

47 Official Gazette of the RS – International Agreements, nos. 8/2010, 3/2018.

48 Popović, Kostić, *Predlozi i sugestije*, 2.

49 Art. 64 of the PITL.

consumption expenses (C). The *lex generalis*, in regard to sharing the burden of proof in tax matters, is Art. 51 of the LTPTA, which stipulates that the TA is required to prove the facts that the existence of the tax liability depends on, while the taxpayer is required to prove the facts diminishing or cancelling of a tax. The personal consumption expenses definitely do not diminish the taxable base – the higher the expenses, the larger the minuend in the equation (4). Therefore, it is the author's opinion that it is on the Unit to prove the amount of personal consumption expenses in the course of the tax audit stage.

Given the fact that no clear definition of “the legality of the property acquired” exists in the LDOP&ST, it is possible that in the course of the audit phase a natural person, who has proved that his/her unreported income (e.g., capital gain) is obtained *lawfully* (e.g., by a sale of the share in a non-resident company), will claim that he/she proved what was required by the Law – the *legality* of acquisition of property (e.g., funds in a bank account) and insist that his/her omission to declare this income actually does not fall within omissions constituting the “illegality of acquisition of property”. They may also file the tax return thus seeking to avoid the reasonable grounds for being suspected of tax fraud, an offence that requires criminal intent.⁵⁰ The imprecision of the norm defining “the legality of the property acquired” may open the door for judicial and/or arbitration disputes with uncertain outcomes.

Pursuant to Art. 14 (3) of the LDOP&ST, non-participation of the natural person in the audit procedure cannot postpone further conduct of the proceedings. In the discussion during the proceedings of passing the Bill, an MP objected that such a provision would affect the natural person who is justifiably prevented from participating in the audit, but the Government's representative replied somehow hastily that in that case the provision of the LTPTA, which provides for appointment of a proxy,⁵¹ would be applied and that in doing so adverse consequences for the natural person would be avoided.⁵² However, Art. 18 (1) of the LDOP&ST prescribes that provisions of the LTPTA are applicable only if the LDOP&ST fails to stipulate differently and in this case it does stipulate differently, proclaiming that any non-participation of the natural person in the audit procedure does not postpone further conduct of the proceedings.

The audit stage is finalised by making minutes of the conducted audit, whereupon the Unit issues the decision on the assessment of the special tax, if the existence of property subject to this levy has been established.

If in the course of the procedure reasonable grounds for believing that a criminal offence was committed are established, the Unit shall notify the police, tax police, public prosecutor's office, and other competent bodies.

The taxable base represents the sum of the indexed⁵³ value of the *property* for

50 Popović, Kostić, *Predlozi i sugestije*, 1.

51 Art. 127 (3) of the LTPTA.

52 RS, Shorthand notes from the 26th extraordinary session of the National Assembly of the Republic of Serbia in 11th convocation, held on 24 February 2020, 20–21, 23, <http://www.parlament.gov.rs/narodna-skupstina-872.html>.

53 The consumer price index is used for the purpose of indexation.

each calendar year subject to the audit, the value of the *property* being the difference between $[(W_2 - W_1) + C]$ in the calendar year, on the one hand, and $(I_r + G + B)$, on the other hand. It should be reiterated that the taxable base is actually unreported income rather than property. The rate of the special tax is 75%. If subsequently, in the course of criminal proceedings, a final judgment is passed determining that certain proceeds are from crime, while the special tax in accordance with the LDOP&ST has already been paid, the court shall offset the tax against the proceeds from crime. The same provision is applicable in the case of confiscation of property resulting from a crime.

The natural person – taxpayer of the special tax may lodge an appeal before the Ministry of Finance. Unlike the “standard” appeal in the tax procedure, envisaged by the LTPTA, the appeal on the decision assessing the special tax postpones the execution of the decision. A taxpayer may initiate judicial proceedings in the Administrative Court against the second instance (final) tax decision within 30 days of the delivery of the second instance decision.

5 THE SPECIFICITIES OF JUDICIAL PROCEEDINGS IN NET WORTH METHOD CASES

Before the LDOP&ST entered into force, the Administrative Court was a catch-all tribunal in a sense that *all* final administrative acts were potentially subject to its judicial review and no specialisation was prescribed.⁵⁴ Art. 24 (1) and (2) of the Law on Judges⁵⁵ prescribes that a judge will receive the cases in a sequence that does not depend on the party’s person and circumstances of the legal matter. A case is assigned to a judge on a basis of the court’s work schedule, in order determined in advance for each calendar year, solely based on the designation number of the case.^{56, 57}

One can argue that at least in the field of taxation, given the complexity of cases, a specialised court would be preferable:⁵⁸ for example, Germany has a separate Tax Court (*Finanzgericht*), while in Slovenia there are two tax departments within the

54 Art. 3 of the Law on Administrative Disputes, Official Gazette of the RS, no. 111/2009 (hereafter: LAD).

55 Official Gazette of the RS, nos. 116/2008, 47/2017 (hereafter: LJ).

56 Art. 25 (1) of the LJ allows that sequencing – but only sequencing – may be altered in the situations envisaged by a law, as well as when a judge is overloaded or justifiably prevented, in accordance with the court’s rules of procedure.

57 Annual Work Schedule of the Administrative Court for 2021, Su I–2 345/20-1 of 23 November 2020, <http://www.up.sud.rs/latinica/godisnji-rasposed-poslova>.

58 Tomić claims that “*it wouldn’t hurt* to establish gradually highly specialised administrative courts (in the first place, court of accounts [sic!], social security court etc.)”. Zoran R. Tomić, “Upravni spor i upravno sudovanje u savremenoj Srbiji”, *Zbornik radova Pravnog fakulteta u Splitu* 47, no 1 (2010): 33. Others are more explicit in their proposals: firstly, specialised chambers, then specialised financial courts. Hrvoje Jelić i Kornelija Miše Bobinac, “Rješavanje sporova iz područja poreznog prava na upravnim sudovima i njihov doprinos pravnoj sigurnosti”, *Zbornik radova Pravnog fakulteta u Splitu* 52, no. 2 (2015): 456.

Supreme Administrative Court.^{59, 60} But achieving this goal requires an intervention in systematic laws. Serbia's legislators, however, decided to follow a different path and through the provision of Art. 21 of the LDOP&ST a specialised corps of judges was created within the Administrative Court, authorised to exclusively deal with the cases concerning final tax decisions issued using the net worth method under the LDOP&ST. These judges must obtain their specialisation through training conducted by the Judicial Academy. This institution is not controlled by the judicial branch of government since out of 9 members of its Management Board, only 4 are nominated by the High Court Council, while the Ministry of Justice supervises the legality of the Judicial Academy's activities.⁶¹ Bearing in mind that the Constitutional Court took the view that the conditions for the election of judges must be prescribed only by the systematic law (i.e., the LJ) and that training at the Judicial Academy cannot be an additional condition introduced by a non-systematic law (the Law on Judicial Academy),⁶² it is possible that the Constitutional Court may also contest Art. 21 of the LDOP&ST, which imposes a new condition for allocating cases to the judges in the Administrative Court, thus violating the provisions of two systematic laws: the LJ and the LAD, while creating discrimination among the judges of the Administrative Court. Art. 21 of the Constitution envisages that the citizens who are in the same legal situation (meeting the criteria prescribed by the LJ) must be treated equally. In addition, the Constitutional Court may challenge Art. 21 of the LDOP&ST against Art. 4 of the Constitution, which prescribes that the legal order is unitive. To summarise: it is the author's opinion that it is inadmissible to change the organisation of a court and the conditions under which already elected judges can carry out their duties by a non-systematic piece of legislation dedicated to a very specific issue.

6 IS THERE STILL A ROOM FOR APPLYING LTPTA ARTICLE 59?

The Government's answer to the poor, practically non-existent results of the best judgment approach under Art. 59 of the LTPTA during more than 18 years of this norm nominally being in effect has not been its improvement followed by allocation of additional resources to the TA in order to enhance this body's performance in this respect, but rather the introduction of a new law to coexist with the previously mentioned Art. 59 of the LTPTA. The creation of the Unit within the TA, which is granted wide ranging competencies, followed by a *de minimis* rule (difference between increase of net worth and reported income exceeding EUR 150,000 in three consecutive calendar years) will contribute to the effectiveness of the procedure

59 AEAJ, "The Role of Administrative Judge in Tax Disputes", accessed 30 May 2021, <https://www.aej.org/page/The-Role-of-Administrative-Judge-in-Tax-Disputes>.

60 Admittedly, there are countries where, like in Serbia (not taking into account Art. 21 of the LDOP&ST), tax cases are dealt with by judges who are not specialised in tax disputes – within administrative courts (e.g., Croatia, Lithuania and Luxembourg [for direct taxes]) or courts of general jurisdiction (e.g., Hungary and Slovakia).

61 Articles 7 (2) and 3 (6) of the Law on Judicial Academy, Official Gazette of the RS, nos. 104/2009, 106/2015.

62 Constitutional Court, Decision IUz-497/2011, Official Gazette of the RS, no. 32/2014.

prescribed by the LDOP&ST, in comparison with the procedure under Art. 59 of the LTPTA, which lacks both elements.

However, given the numerous serious problems of constitutional law, administrative law and tax law nature brought about by the LDOP&ST and discussed above, one may wonder why the existing provisions on cross-checking of the income tax returns with the worth accretion from the LTPTA were simply not amended to include the missing norms, which could overcome the existing obstacles for application of Art. 59 of the LTPTA, instead of establishing a peculiar legal dualism involving the parallel existence of two pieces of legislation actually dealing with the same issue – how to discover and tax unreported income using the net worth method. Under the dualism, two categories of the taxpayers have been created. On the one hand, there are those who can ironically be called “*de luxe* natural persons”, to whom the LDOP&ST is applicable and consequently the special tax at the rate of 75%. On the other hand, there are “standard” taxpayers subject (once the TA decides to apply the Law) to cross-checking of the income tax returns with the worth accretion in accordance with Art. 59 of the LTPTA and consequently subject to the personal income tax on other income, at a rate of 20%. With unreported income of up to EUR 150,000 a taxpayer may be exposed to the 20% rate, while unreported income of EUR 150,001 or more triggers the 75% tax rate, whereby it is not a matter of progressive rates of a single tax, but drastically different rates of two levies. In the author’s opinion, such solution violates the anti-discrimination clause contained in Art. 21 of the Constitution.

7 CONCLUDING REMARKS

The analysis has shown that “best judgment” assessments are widely applied in comparative tax law when taxpayers fail to file tax return, in spite of the statutory requirement to do so, or when the tax return has been filed with inaccurate data. Along with some other countries, Serbia uses the net worth method, based on cross checking of the income tax returns with the worth accretion. As noted above, at the present there are two pieces of legislation concurrently regulating the net worth method: Art. 59 of the LTPTA, which since 2003 has not produced any effect because there was no political will to implement it, and the 2021 LDOP&ST, kept high on the Government’s agenda as a powerful tool in the fight against large (real and alleged) tax evaders, possibly political adversaries. Its effectiveness is yet to be seen, but in spite of the new resources allocated for the purposes of the special Unit within the TA, a number of legal obstacles remains. Apart from the apparent discriminatory dualism, manifested in the existence of two pieces of legislation containing provisions on the net worth method in concurrent but different manners (20% tax for one group of taxpayers vs. 75% tax for the other⁶³), there are numerous norms that, if nothing else, raise the issues of interpretation and application, and at worst can lead to the examination of their compliance with the Constitution, which would eventually mean their annulment on the basis of violation of a number of the constitutional provisions.

63 Additionally, the taxable base for the former group of taxpayers is narrower, since their personal consumption expenses are deemed to be zero.

It is pointed out in the tax law literature that although the net worth method “is a most useful method, it has considerable limitations”.⁶⁴ Namely, whenever the statement of the taxpayer’s capital at the beginning of the tax (calendar) year⁶⁵ is compared with the statement of the taxpayer’s capital at the end of the tax (calendar) year, a problem may arise in cases where the taxpayer submits a capital statement for the first time, because they may “artificially increase it with a view to covering up taxable income, evasion of the tax on which was practised or intended. In those cases where capital statements were suspected to have been overstated, the Revenue [Israeli tax authorities – *author*] found it very difficult to discredit the statements made by the taxpayers”.⁶⁶ In Serbia’s LTPTA the obligation to submit initial capital statement (actually statement on total assets) within 10 months from the Law coming into effect was prescribed by Art. 186 and limited to those natural persons (including entrepreneurs) whose total worldwide assets exceed the value of RSD 20 million (approx. EUR 307,000 at the average 2003 exchange rate).⁶⁷ It is possible that a certain number of these natural persons overstated the value of their assets (W_1) in order to diminish the difference ($W_2 - W_1$), but the response to the statutory requirement for submitting such statement was generally poor, since many preferred to stay low, expecting (we know now, justifiably) that due to an absence of political will no further action by the TA would be initiated. A similar attempt to establish the initial position for the application of the net worth method was conducted in 2007 but it was also in vain. To reiterate: the net worth method envisaged by the LTPTA has not yielded any results yet.

The lawmaker who in 2020 enacted the LDOP&ST decided to skip the stage of submitting the initial capital statement. The new approach resembles the U.S. “thorough investigation” method, which requires that the Internal Revenue Service “make every effort to determine opening assets and liabilities, while not being held to a mathematical certainty”.⁶⁸ In other words, the tax authorities are required to meet the threshold of “reasonable certainty” of the opening net worth figure. Pursuant to Art. 11 of the LDOP&ST, the value of the opening, as well as the closing, assets equals the sum of the values of real estate, financial instruments, interests in companies, business equipment, motor vehicles, vessels and aircraft, savings, cash and other property rights (e.g., intellectual property). The valuation details are prescribed by the Regulation.

In spite of these limitations, the conducted analysis did show that the net worth method is a useful tool in performing best judgment tax assessments. However, the issue is not whether this method should be included in Serbia’s anti-evasion policies, but the quality of the legislative framework and availability of the resources at the TA’s disposal. With respect to the former, adding to the above-mentioned comments on

64 Lapidoth, *The Use of Estimation*, 112.

65 Or at the beginning of the control period within the calendar year.

66 Lapidoth, *The Use of Estimation*, 112.

67 Those natural persons whose worldwide assets exceeded RSD 10 million but did not exceed RSD 20 million were given an option of submitting an initial capital statement.

68 *Brown, PC*, “Net Worth Method of Proving Income”, accessed 5 June 2021, <https://www.browntax.com/tax-law-library/methods-of-proof/net-worth-method-of-proving-income/>

unprecedented legal dualism and the resulting discrimination, there is an inaccuracy in defining the subject-matter of the procedure envisaged by the LDOP&ST (whether it is the *origin of property* or the *difference between the increase in property and declared income*) and the resulting legal consequences that were the subject of the previous analysis. Equally problematic are the examples of violation of the constitutional principle of the unity of legal order, whereby a specific statute such as the LDOP&ST contains provisions that amend the solutions stipulated by the systematic laws, as in the case of the LAD and the LJ (by introducing specialisation of judges solely for disputes resulting from the application of the provisions of the LDOP&ST), or in the case of mandatory transfers or secondments of certain non-governmental employees to the Unit of the TA. With respect to the resources at the TA's disposal, one can only praise the Government's decision to make this version of the net worth method workable. However, once the proceeds from the special tax start to fill the budget, a sophisticated analysis of the impact of such reallocation of resources on the proceeds from other fiscal instruments should be carried out.

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Sažetak

UNAKRSNO USPOREĐIVANJE PRIJAVLJENOGA POREZA NA DOHODAK S POVEĆANJEM IMOVINE: ZAKONODAVSTVO SRBIJE U USPOREDNOPRAVNOM KONTEKSTU

U ovom se radu analizira srpski *Zakon o utvrđivanju porekla imovine i posebnom porezu* iz 2021. i uspoređuje s rješenjima koja se pronalaze u usporednom poreznom pravu, a koja se temelje na unakrsnoj procjeni prijavljenoga dohotka i porasta neto imovine. Nakon što su utvrđene prednosti i ograničenja, tzv. *net worth* metode, autor ukazuje na to da je zakonodavac izdvojio znatne resurse za primjenu Zakona, računajući na propagandni učinak i mogućnost da otkriveni neprijavljeni dohodak fizičkih osoba, koja mogu biti i politički oponenti vlasti, bude oporezovan po stopi od 75 %. Još od 2003., tzv. *net worth* metoda je zastupljena u *Zakonu o poreskom postupku i poreskoj administraciji*, ali se ne primjenjuje zbog nedostatka političke volje. Paradoksalno je što je ta odredba zadržana u sustavu, tako da od 2021. postoji dualizam – za jedne će obveznike i dalje vrijediti odredbe iz 2003. (s porezom od 20 %), a za druge novi zakon, s gotovo konfiskatornom stopom. Analiza pokazuje da su brojne odredbe zakona iz 2021. suprotne s odredbama Ustava – o jedinstvu pravnoga poretka, zabrani diskriminacije, načelu zakonitosti poreza i nedopuštenosti retroaktivnosti zakona. Ako bi se uklonili navedeni nedostaci, primjena, tzv. *net worth* metode bi imala smisla.

Ključne riječi: *metoda unakrsne procjene; neprijavljeni dohodak; povećanje imovine; jedinstvo pravnoga poretka; konfiskatorni porez.*

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