



KRESTON
MDM

INSTRUCTIONS FOR **TAX INSPECTORS** FOR THE APPLICATION OF THE INDEPENDENCY TEST

BRIEF OVERVIEW

Instructions for the application of Article 85, paragraph 1, item 17) of the Law on personal income tax (hereinafter: the Law) in tax control - independence test.

The Tax Administration has issued Instructions for **tax inspectors**, which clarifies the application of the independence test effective as of 1.3.2020. The Guide was published because there were different interpretations and ambiguities regarding the implementation. The published guidance does not change the substance of the independence test and does not introduce new rules. The Guide itself is 90 pages long, so we have prepared a brief overview.

Criterion 1

The principal or the related party assigns opening hours to the lump-sum entrepreneur or entrepreneur, or the vacations and absences of the lump-sum entrepreneur or entrepreneur are dependent on the decision of the principal or the related party with the principal and the compensation to the lump-sum entrepreneur or entrepreneur is not reduced in proportion to the time spent on vacation.

The first criterion for the independence test is set alternatively (i.e., **it is sufficient for one of the two sub-criteria to be fulfilled**).

In analyzing the relationship between the Entrepreneur and the Principal, one should rely on the definitions of the Labor Law, which defines working time as "**the period of time during which the employee is obliged, i.e. available to perform work according to the orders of the employer, at the place where the jobs are performed**".

The **tax inspector** should ask two questions:

1. Do the **vacations and absences** of the Entrepreneurs depend on the decision of the Client?, if yes,
2. Is the **entrepreneur's compensation reduced in proportion to the time spent on holiday?**

If the **tax inspector** determines that the answer to the first question is yes and the second is not (therefore, the **tax inspector** analyzes both elements), in that case it is considered that the Entrepreneur is not independent for the purposes of applying this criterion, that is, he fulfills the criterion of the independence test.

Criterion 2

A lump-sum entrepreneur or entrepreneur typically uses premises provided by principal or performs tasks in a place designated by the principal or a related party with the principal for the purpose of performing the tasks entrusted to him.

If the Entrepreneur normally performs his activities in the premises of the Principal or in another place designated by the Principal, such relationship denies the entrepreneur's independence. One of the elements that may be relevant for assessing the fulfillment of this criterion is whether the Entrepreneur, who sometimes performs his activities on the premises of the Client, has **secured his own business premises that would enable him to perform his business even after the termination of the relationship with the Client**. However, the fact that the Entrepreneur visits the Principal to e.g. submitting reports or arranging further business, without using the premises of the Client for work, cannot be interpreted as the Entrepreneur habitually using the premises of the Client for the purpose of performing the tasks entrusted to him.

Criterion 3

The principal or a related party with the principal performs or arranges professional training or further education of lump sum entrepreneurs or entrepreneurs.

Hiring an independent person means that the person has been trained, i.e., trained to perform the task for which he or she was hired. The assumption is that the **self-employed person invests his or her own funds in training and education**, in order to improve his / her skills and thus better position themselves in the market. In addition, the **independent hired person independently and freely decides the skills or abilities for which he or she needs additional education**. If the Principal organizes (or determines the type and other elements of vocational training or training and / or bears the cost of such training / training) or performs training or vocational training of the Entrepreneur, this fact indicates the Entrepreneur's independence.

When analyzing the fulfillment of this criterion, the **tax inspector** will, in addition to the fact of the existence of such professional training / training, also determine the nature and purpose of the training.

Criterion 4

The Principal has hired a lender entrepreneur or entrepreneur after advertising in the media the need to engage individuals or by hiring a third party who is usually engaged in finding suitable people for employment and whose service has resulted in the engagement of that lender entrepreneur or entrepreneur.

Criterion 4 is set alternatively, so **if one of the sub-conditions is satisfied, the criterion 4 is considered fulfilled.**

The employer hires the employee to perform the work, in terms of expertise, without determining the specific result of the work (i.e., **the employee continuously performs his work for the employer, on various tasks**). On the other hand, when hiring an **external supplier, the request for bidders is primarily focused on the result to be delivered and the ability of the external supplier to deliver the required result.** Accordingly, it is not relevant to the contractor whether the task will be performed by a legal person, entrepreneur or individual, but it is important to him whether such an external supplier has the capacity to deliver the result in the manner required by the client.

If the Client engages third parties who are usually engaged in finding persons suitable for work engagement, which results in the engagement of the Entrepreneur, this will affect the assessment of the independence in the Entrepreneur-Client relationship and the fulfillment of this criterion.

Criterion 5

The principal or a related party with the principal provides its own basic tools, equipment or other basic tangible or intangible assets required for the regular work of the lump-sum entrepreneur or entrepreneur or finances their acquisition, except for specialized tools, equipment or other specialized tangible or intangible assets executing a specific job or order, or the principal or a related party with the principal normally manages the work process of the lump-sum entrepreneur or entrepreneur, except for such management which entails giving a basic order in connection with the job ordered and reasonable control of the results of the work or supervision of the principal, as a good businessman, over the performance of the work he ordered.

Criterion 5 is set alternatively, so if **one of the sub-conditions is satisfied, criterion 5 is fulfilled.**

If the Principal:

1. **provides its own basic tools**, equipment or other basic tangible or intangible assets to the Entrepreneur, or
2. **finances the purchase of own basic tools**, equipment or other basic material or intangible assets for the Entrepreneur

such fact **indicates lack of independence of the Entrepreneur**, whose work depends on the Principal's investments, and who would not be able to perform his business without the support of the Principal.

The feature of a dependent relationship, such as that of the employer and the employee, implies that the employer sets the work process according to which the employee performs his work - the employer determines the place and time of work, the schedule of duties, equipment and materials that the employee will use for work, priorities, etc. and oversees the performance of the employee's work. On the other hand, in the case of third-party suppliers, the primary goal of engaging suppliers is to produce a specific result, not the process itself. Consequently, **the greater and more established the role of the Principal in overseeing the activities undertaken by the Entrepreneur in producing the results of the work ordered, the smaller the Entrepreneur's independence.**

Criterion 6

At least 70% of the total revenue generated by the lump-sum entrepreneur or entrepreneur over a 12-month period beginning or ending in the tax year concerned is from a single principal or a related party with the principal.

The assumption is that the **Independent Entrepreneur performs activities in his code of activity for a larger number of persons**, and that the termination of performing activities for one Principal will not affect the termination of the Entrepreneurship activities.

The criterion related to the percentage of total revenues is observed in the period of **12 months preceding the specific moment of receipt of each (and even the first in a row) payment**. When assessing the fulfillment of this criterion, the **tax inspector** should pay attention to the potential relation of the payers within the meaning of Article 59 of the Law on Corporate Income Tax (**related persons**).

In addition, if the payer is an **intermediary payer** within the meaning of Article 85, paragraph 16 of the Law, the **tax inspector** shall apply criterion 6 to indirect Principal Investors.

Criterion 7

A lump-sum entrepreneur or entrepreneur performs activities in the activities of the originator or a related party with the principal, and for such activities his engagement contract does not contain a clause under which the lender entrepreneur or entrepreneur bears the usual business risk for the job delivered to the client of the principal or a related person with the principal, if any client exists.

A self-employed person (be it a legal entity or an entrepreneur) bears the risks associated with the performance of such an activity - **from market and profitability risks, collection risks, to the risk of failure to perform or improperly perform the work to the client**, that is, the existence of responsibility to the client. On the other hand, **an employee does not bear such risk to his employer**. In other words, negligence of an employee may result in dismissal, which must be carried out in accordance with the Labor Law, provided that the employee is entitled to earnings until the termination of the employment contract.

In assessing whether an Entrepreneur performs activities in the activity of the Principal, the **tax inspector** takes into account **all the activities of the Principal** that he performs for the purpose of earning income, and not exclusively the predominant registered activity.

Criterion 8

The contract for hiring an entrepreneur or a lump sum entrepreneur contains a partial or complete ban on the entrepreneur or a lump sum entrepreneur to provide services under a contract with other principals, except for a partial prohibition involving the provision of services to a limited number of direct competitors to the principal.

A self-employed person (be it a legal entity or an entrepreneur) **usually has more clients, that is, he is free to market his skills and be hired by more clients**. Autonomy in this way is reflected in the fact that such a person reduces the risk of termination of business due to the loss of the sole client.

Accordingly, the **tax inspector** in the process of control analyzes the contract of engagement of the Entrepreneur, in order to determine whether it contains **a prohibition or restriction on performing activities for other persons besides the Principal**.

Criterion 9

A lump-sum entrepreneur or entrepreneur carries out activities for a fee for the same principal or for a related party with the principal, continuously or intermittently for 130 or more business days for a period of 12 months beginning or ending in the tax year concerned, whereby the activity is performed in one business year day is considered to be an activity in any period during that working day between 00 and 24 hours.

130 or more working days are observed in the **12 months preceding a specific moment**.

Example: The **tax inspector** performs tax control of the correctness of the application of the independence test for 2021. The **tax inspector** will analyze the fulfillment of this condition for a period of 12 months in relation to 12/31/2021. If the Entrepreneur has been engaged in activities for 130 days or longer for a period of 12 months compared to 31.12.2021, criterion 9 is fulfilled for the entire review period. If not, the **tax inspector** will look at the previous 12 months for each payment to the Entrepreneur during 2021 to determine whether the Entrepreneur has performed the activity for 130 days or longer.

If the Entrepreneur spends 30 minutes one day in performing the activities for the same Principal, for the purposes of applying this criterion, he shall be considered to have performed the activities one working day. In addition, if the Entrepreneur performs activities for more than one Client, and within one day performs activities for each Client, the entrepreneur shall be considered to have performed activities for one working day for each Principal. The **tax inspector** should bear in mind that the term business day within the meaning of criterion 9 means any day of the week in which the entrepreneur carries out activities for a fee.

If the Entrepreneur and the Principal have more than one engagement contract, the **tax inspector** will take into account all the employment contracts relevant for a certain period. For example, if the engagement contract is concluded for an indefinite period of time whereby the Entrepreneur is permanently or regularly / continuously at the disposal of the Principal and the Entrepreneur issues invoices for his work during that 5 calendar month period, the **tax inspector** will consider the criterion 9 to be fulfilled.

FEEL FREE TO CONTACT US FOR ANY ADDITIONAL INQUIRIES!

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