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TAXATION AND FORMS OF ORGANISING BUSINESS ACTIVITIES**

ABSTRACT: *This paper takes sample tax regimes and tendencies from the developed countries in the EU-15 and the USA, and uses them to analyse the influence of taxation on the choice of organisational form of profit-oriented entities in Serbia. In order to understand how the procedure of taxation affects the sphere of business decision-making it is necessary to focus on the tax status of business losses and valorisation and the effects of the double taxation of dividends. The rule of successive deduction of losses ensures the fiscally transparent entity receives a tax saving in the form of a reduction of the present value of the total paid tax. Meanwhile the corporation is handicapped because it postpones loss deductions, that is, it postpones tax saving, which directly influences the level of the present value of saved tax. The global trend of gradually moving from the classical system towards shareholder relief provision, above all in the form of a reduced withholding tax rate on dividends, has two opposing features: it simplifies the tax procedure while neglecting the distributional aims (consequences) of taxation. The analysis of a particular practical example from the Serbian tax context enables us to draw a conclusion in relation to the relative taxes paid by entrepreneurs versus enterprises. The developed countries favour fiscally transparent entities, whereas Serbia allocates tax privileges to enterprises.*

KEY WORDS: *personal income tax, corporate income tax, forms of organising business, economic behaviour, tax saving, developed countries, Serbia.*

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1. INTRODUCTION

A business activity can be organised as a profit-oriented entity, non-profit entity, or financial institution. In this paper we will look at the taxation of profit-oriented entities that produce goods and provide services in the exemplary developed countries of the EU-15 and the USA and in Serbia. The profit-oriented entities of the developed countries appear in four typical organizational forms which are grouped into two different tax categories. The first tax category is that of 'fiscally transparent entities', which do not pay taxes at the level of the entity (entrepreneur, partnership, S corporation). In certain developed countries, typically the USA, certain business activities can be registered in a corporative organisational form (S corporation), in accordance with precise legislation governing the manner of its founding, the number of shareholders, and the kind of available shares (Smith, William & Maloney, 2011). In this case the operating income of the corporation, although determined regardless of the personal income of the owner, is not taxed at the level of the entity. The operating income/loss is distributed to the owners proportionally to the size of their ownership of shares in the corporation, and then it is taxed as part of their personal income - an integrated approach to the taxation of corporate income. The second tax category is that of 'real corporations', which are treated as independent subjects in terms of tax jurisdiction, and pay tax on 'their' income at the level of the entity - a separate approach to the taxation of corporate income. Thus individuals and corporations are the two primary entities that pay the corresponding taxes, comprehensive personal income tax and corporation income tax, on the financial results of business activities.

The working hypothesis of this paper is that the tax system influences the choice of the form of organising a business activity, because the process of taxation activates tax planning based on the concept of maximising the net present value of cash flow. In other words, it is necessary to explain how taxation influences business activities, and how this influence can be harmonised with the process of making business decisions with the aim of maximising tax savings and profitability.

Other than the introductory and concluding considerations the structure of the work will be operationalized through four complementary tasks. Firstly, in the second chapter we will evaluate the tax position of a negative financial result in the tax jurisdictions of the developed countries, depending on whether it is reported within the fiscally transparent or corporative organisational form. Then in the third chapter we will consider the valorisation and effects of economic double taxation of dividends in the developed countries. In the fourth chapter,

"Taxation and forms of organising business in Serbia", we will offer an answer to the following question: How is the procedure of taxation of the economic actors in Serbia designed? In the fifth chapter we will discuss whether in Serbia tax-preferential status is given to the entrepreneur or to the enterprise, using specific empirical research as an example of the Serbian tax situation.

2. THE TAX STATUS OF AN OPERATING LOSS IN DEVELOPED COUNTRIES

The developed countries present the idea that individuals and tax transparent entities should be placed at the same tax level, through the concept of comprehensive income (Robert Murray Haig - Henry Simons' concept of comprehensive income; Hyman, 2010). This concept has important implications for shaping the tax systems of the developed countries, above all for the tax status of operating loss. Fiscally transparent entities are not subject to tax at the level of the entity. If a fiscally transparent entity distributes its income to individuals, then the distribution of the operating income is a non-taxable item at the level of the entity. If a tax transparent entity reports a loss, individuals can compensate their operating losses, within the current accounting period, from the operating income of the same period. The possible remaining sum of the net operating loss can be deducted from the remaining income sources of the individual, up to the legally defined amount. The rule of a partial deduction of operating losses is designed to discourage individuals from creating operating losses in order to minimise their taxable income.

The economic actors face the symbiosis of risk and investment Taking risks is a promoter of economic growth. Taxation has instruments available to encourage entrepreneurship (see: Crawford & Freedman, 2010). The tax treatment of operating loss differs depending on whether it is shown within the tax transparent or corporate organisational form (see: Willis, Hoffman, Maloney & Raabe, 2005; Jones, 2005; Smith, William & Maloney, 2011; Doernberg, Abrams & Leatherman, 2008). With the aim of illustrating the different tax implications of a current deduction of loss and of a time lag in loss deductions, let us suppose that individuals organise a hypothetical business activity represented by characteristic balance positions (Table 1).

Table 1. Loss or taxable income of a hypothetical business activity (in 000 of monetary units, m.u.)

The business year	The total income	The legally allowed deduction	The loss (L) or taxable income (TI)
1. The current year	300,000	(600,000)	L = (300,000)
2. The second year	500,000	(600,000)	L = (100,000)
3. The third year	1,300,000	(800,000)	TI = 500,000

Notes to Table 1: The total income is per definition reduced by certain costs incurred during its making. Although the income tax on business activity is very complex, its structure can be accurately presented by the following simplified equation: tax = (the total income – allowed deductions and exemptions) x the appropriate tax rate.
Source: Processed by the author.

The option of 'successive deduction of losses' is available when the business activity is realised through the fiscally transparent organisational form. Individuals continuously deduct their losses as they appear in certain business years. The individuals have their losses deducted in the current business year (600,000,000.00 m.u.) and in the second business year (600,000,000.00 m.u.). At the end of the third business year the individuals will have the tax assessed and paid on the tax base of 500,000,000.00 m.u. - this sum will be positioned under "taxable income" (the unique tax treatment of partners and partnerships can be traced to three legal concepts: the aggregate or conduit concept, the entity concept, and the combined concepts. See: Willis, Hoffman, Maloney & Raabe, 2005, p. 21-9).

When the business activity is realised in the corporate organisational form, the option of 'loss transfer' is available; that is, the operating losses reported in the tax balance from the current accounting period can be transferred at the expense of the income reported in the annual tax balance for the future accounting periods (see: Jones, 2005; Auerbach, Devereux & Simpson, 2010; Smith, William & Maloney, 2011). The losses are not deducted in the current business year and the following business year. At the end of the third business year, in which after three years of running the business net income is made for the first time, the corporation deducts the losses, assesses and pays the taxes on a tax base of 100,000,000.00 m.u.

In order to clearly differentiate between the two tax regimes we will observe a unique tax situation using an identical tax rate (20%), an identical discount rate (7%), and an identical total amount of paid tax (TAPT = 20,000,000.00 m.u.) for

both organisational forms. The presented hypothetical_example (Table 2) shows that the tax rules enable the tax transparent entity to significantly reduce the present amount of total paid taxes (PVTPT = 8,600,000.00 m.u.) compared to the much bigger present amount of total paid taxes serviced by the corporation (PVTPT = 17,460,000.00 m.u.). A tax benefit or a tax sanction is conditioned by the moment of implementation of the deduction. The corporation postpones the loss deductions for three years and that directly influences the level of the present value of the saved tax amount.

Table 2. Comparative analysis of the present value of saved tax and the present value of paid tax in the different organisational forms of business activity (in 000 m.u.)

Tax transparent entity				
The business year	The successive deduction of the loss (SDL) or the taxable income (TI)	The saved tax (ST), the paid tax (PT) or the total amount of the paid tax (TAPT)	The discount factor	The present value of the saved tax (PVST), the present value of the paid tax (PVPT) or the present value of the total paid tax (PVTPT)
1. The current year	SDL =(300,000)	ST = 60,000	-	PVST= 60,000
2. The second year	SDL=(100,000)	ST = 20,000	0.935	PVST= 18,700
3. The third year	TI = 500,000	PT = (100,000)	0.873	PVPT= (87,300)
		TAPT=(20,000)		PVTPT = (8,600)
Corporation				
The business year	The loss transfer (LT)) or the taxable income (TI)	The saved tax (ST), the paid tax (PT) or the total amount of the paid tax (TAPT	The discount factor	The present value of the saved tax (PVST), the present value of the paid tax (PVPT) or the present value of the total paid tax (PVTPT)
1. The current year	LT = (300,000)	-	-	-
2. The second year	LT = (100,000)	-		-
3. The third year	TI = 100,000	PT= (20,000)	0.873	PVPT= (17,460)
		TAPT= (20,000)		PVTPT= (17,460)

Source: Processed by the author.

3. VALORISATION AND EFFECTS OF DOUBLE TAXATION IN THE DEVELOPED COUNTRIES

The corporation is a taxpayer per se, so corporate income tax is determined regardless of the tax circumstances of the shareholders who own the corporation. The corporation is subject to corporate income tax in the process of acquiring income, but personal income tax can be activated in the process of profit distribution to the shareholders of the corporation. The tax consequences of profit distribution to corporate investors are significantly different from income distribution to the owners of fiscally transparent entities, which introduces the question of the influence of taxation structures on the business decision-making process.

Taxation of corporate earnings according to two different tax regimes continues to be controversial (Pechman, 1966, p. 132). The level of the rate of personal income tax on dividends can emit three primary distortive influences in the area of business decision-making, the last of which is particularly important for the present research: (1) the distortion between the retained and distributed profit of the corporate sector (see: European Commission, 2011a, 2011b; Brys, Matthews & Owens, 2011); (2) the distortion between debt and shares (see: Feldstein, Green & Sheshinski, 1979; Bradford, 1979; Auerbach, 2002); (3) economic double taxation can cause so-called lock-in effect and disturb capital flow between the corporate and non-corporate sectors. It is necessary to outline the stormy professional discussions and opposing arguments concerning the question of designing a corporate income tax system, that is, of the validity of higher or lower taxation of dividends (Meade, 1978; Morck & Yeung, 2005; Djankov, Ganser, Mc Liesh, Ramalho, & Shleifer, 2008; Gruber, 2010).

Individual business organisers are above all interested in choosing the organisational form which will maximise after-tax income. In order to demonstrate clearly the appropriate tax implications we will observe a hypothetical tax situation, using an identical amount of taxable income (100,000.00 m.u.) and an identical level of personal income tax rate (15%) for both organisational forms, with a corporate income tax rate of 35%. The hypothetical example presented in Table 3 shows that tax rules enable the total income of the tax transparent entity to be distributed to the owners and taxed at the marginal rate of comprehensive personal income tax (15%), so that the available after-tax income amounts to 85,000.00 m.u. When the business activities are registered in a corporate organisational form taxed through the classical system, the double taxation of dividends passing through the corporate ownership structure results in the income being taxed at an effective

rate of 44.75%, so that the money actually available to the owners amounts to only 55,250.00 m.u. In the presented hypothetical situation, the choice of the fiscally transparent organisational form seems rational.

Table 3. Hypothetical example of available after-tax income in the current year in the alternative forms of business organisation (in monetary units, if not marked in any other way)

Tax transparent entity: a partnership	
1. The taxable income	100,000.00
2. The personal income tax rate	15%
3. The amount of personal income tax	15,000.00
4. The effective tax rate	15%
5. The available after-tax income	85,000.00
Corporation: the classical system	
The corporation level	
1. The taxable income of the corporation	100,000.00
2. The corporation income tax rate	35 %
3. The amount of corporation income tax	35,000.00
4. The profit to be distributed	65,000.00
The shareholder level	
5. The personal income tax rate	15%
6. The received dividend (the profit distributed to the shareholders)	65,000.00
7. The amount of personal income tax	9,750.00
8. The total amount of paid tax (the sum of the two taxes)	44,750.00
9. The effective tax rate for the classical system	44.75%
10. The available after-tax income	55,250.00

Source: Processed by the author.

The classical system of taxation introduces the question of double taxation. The developed countries consider double taxation of the part of the shareholders' income that comes from dividends as a barrier to the efficient functioning of the corporate sector. It is necessary to bear in mind the different conceptual arguments and the different practical models for the integration of the two characteristic tax forms: when taxing dividends, the fact should be respected that tax has previously been paid on the income which dividends were paid out from, and ensure tax relief for the shareholders (dividend relief approach). The tax relief (or 'tax integration') practically means different methods of reduction

or elimination of double taxation of the dividends, whose effect is originally manifested exactly in the ambience of the classical system of corporation income tax.

How is the problem of double taxation solved in the developed countries? The last half a century has seen a change in the treatment of financial 'distribution' through taxation at the level of the corporation and at the level of shareholders. Although there have been numerous variations as well as genuine national solutions, generally there has been a global orientation towards lessening capital revenue taxation and a gradual movement from the 'classical system' toward 'shareholder relief provision' in the form of a reduced rate of withholding tax on dividends (see: Pechman, 1966; Messere, De Kam & Heady 2003; EC, 2003; Devereux & Sorensen, 2005; Dahlberg, 2005; Cnossen, 2005; OECD, 2007; Mankiw, Weinzierl & Yagan, 2009).

What is the effect of this tax change on the consequent change in the size of the double tax? OECD (1973; 1991), Wiseman & Davenport (1974) and Cnossen (1993; 1996, p. 71) initially established the mainly accepted methodology for calculating the size of the reduction in the double tax, which has been frequently used by numerous authors (see: Poterba, 2004; Blažić & Bašagić, 2005, for example). The basic idea for calculating the level of mitigation in the double taxation of dividends is represented by the following equation: the degree of mitigation of the double tax = the size of the double tax in the classical system – the size of the double tax in the chosen system / the size of the double tax within the classical system – the size of the appropriate personal income tax.

Using this methodology to analyse the changes in effective tax rates and their implication for the size of double tax, as specified in Table 4, the central question arises: What professional messages should be underlined concerning the relative change in double taxation? Determining the amount of reduction in double taxation of dividends, that is, measuring the size of the 'relief for dividends', is usually done by comparison to the size of the double tax within the classical system, as the highest double tax amount that can be paid by the unit of the distributed income. Since the classical system is operationalized in the situation of comprehensive personal income tax, the amount of reduction in double tax is determined according to the level of the appropriate marginal rate of personal income tax for the particular shareholder. For the purpose of this paper we will use hypothetical marginal rates of personal income tax (10%, 15%, 25%, 28%, 33%, 35%), a corporate income tax rate (35%), and a reduced rate of the withholding tax on dividends (15%). We have chosen a greater number of rates for personal

income tax in order to stress the effects of different corporate tax systems on different income amounts. Now we can count the amount of reduction in double taxation, compared with the classical system.

Table 4. Comparison of the size of double taxation in a hypothetical system of a reduced rate of withholding tax on dividends, to the size of double taxation within a hypothetical classical system (in monetary units, if not marked in any other way).

Classical system						
The corporation level						
1. The taxable income of the corporation = 100,000.00						
2. The corporation income tax at the rate of 35% = 35,000.00						
3. The profit meant for distribution = 65,000.00						
The shareholder level						
4. The personal income tax rate	10%	15%	25%	28%	33%	35%
5. The received dividend	65,000	65,000	65,000	65,000	65,000	65,000
6. The amount of personal income tax	6,500	9,750	16,250	18,200	21,450	22,750
7. The total amount of paid tax (the sum of the two taxes)	41,500	44,750	51,250	53,200	56,450	57,750
8. The effective tax rate for the classical system	41.50%	44.75%	51.25%	53.20%	56.45%	57.75%
9. The increase of the effective tax rate for the classical system compared to the personal income tax rate	315.00%	198.30%	105.00%	90.00%	71.00%	65.00%
System of a reduced rate of withholding tax on dividends						
The corporation level						
1. The taxable income of the corporation = 100,000.00						
2. The corporation income tax at the rate of 35% = 35,000.00						
3. The profit meant for distribution = 65,000.00						

The shareholder level						
4. The personal income tax rate	10%	15%	25%	28%	33%	35%
5. The received dividend	65,000	65,000	65,000	65,000	65,000	65,000
6. The withholding tax on dividend (the reduced tax rate =15%)	9,750	9,750	9,750	9,750	9,750	9,750
7. The total amount of paid tax (the sum of the two taxes)	44,750	44,750	44,750	44,750	44,750	44,750
8. The effective tax rate for the reduced-rate system	44.75%	44.75%	44.75%	44.75%	44.75%	44.75%
9. The increase of the effective tax rate for the reduced-rate system compared to the personal income tax rate	347.5%	198.3%	79%	59.82%	35.61%	27.86%
Change in the amount of double taxation in the reduced-rate system compared to the classical system						
Extra taxing of dividends, taxation according to the classical system or dividend relief	-10.32%	0%	24.76%	33.53%	49.8%	57.14%

Source: Processed by the author.

The data calculated in Table 4 enable us to make the following comments:

The lowest income class has an increase in double taxation, compared to the classical system (since the personal income tax rate for the lowest income class is lower than the reduced withholding tax rate on dividends there is an increased tax burden, compared to the level of the tax burden in the classical system).

The second income class, which also comprises the poorer part of the national population, is taxed exactly the same as under the classical system (since the personal income tax rate is identical to the reduced withholding tax rate on dividends the reduction in double taxation is 0%).

The third, fourth, fifth, and sixth income classes, which cover the middle- and high-income segments of the national population, have a reduction in double taxation (dividend relief). The amount of reduction in double taxation, compared to the classical system, increases with the growth of income, 24.76%, 33.53%, 49.8% and 57.14%, respectively, which is directly opposite to the principle of horizontal (vertical) equity, with the consequent regressive effects that this implies.

The global trend of gradually moving from the 'classical system' towards 'shareholder relief provision', above all in the form of a reduced withholding tax rate on dividends, has two original and opposing features. The first feature is simplification of the taxation procedure and the subsequent reduction in the cost of running the tax system (administrative and compliance costs). The second feature is the regressive nature of the reduced rate system, in that the dividend relief is highest for the highest rate of personal income tax and gradually lessens as it moves towards the lower rates of personal income tax.

4. TAXATION AND FORMS OF ORGANISING BUSINESS IN SERBIA

According to Serbian domestic tax jurisdiction (2010, 2011a, 2011b), economic activity can be registered in ten organisational forms, which are classified in two different tax categories: entrepreneur (an individual, a payer of personal income tax, who is self-employed, including the category of lump-sum taxation of self-employed taxpayers), and company. The term 'company' comprises the entities of persons (entities with unlimited joint and several liability) and the entities of capital (Limited Liability Companies). Unlike most developed countries, Serbian tax jurisdiction does not distinguish between entities of persons and entities of capital, and they are both classified as corporate income tax payers.

The option of successive deduction of losses is not available to the entrepreneur in Serbia. The entrepreneur is not in a position to use tax savings based on successive deduction losses in the years they are reported because the tax treatment of losses from previous years is reported in the entrepreneur's tax balance, in accordance with corporate income tax law.

Enterprises pay corporate income tax of 10%, levied on reported profit. After the distribution of the profit the individual who acquires the capital revenue pays personal income tax on the income from the capital at an identical rate of 10%. Since only a part of the profit distributed to the shareholders is subject to double taxation and at a rate identical to the corporate income tax, we conclude that the

Serbian tax creators chose 'specific relief' at the shareholder level of the schedular type. This solution means that total taxation, with corporate tax and personal tax, depends on the ratio of the part of the profit distributed in dividends to the total reported taxable profit. Because only a part of the profit, the dividends distributed to the shareholders, is subject to double taxation, the effective tax rate increases/reduces as a function of the size of the distributed profit.

The capital revenue from dividends and the share of profits are not subject to taxation by annual personal income tax, because the capital revenues, according to law, are not included in the annual tax base. This solution, as well as other solutions which we are not focusing on here, suggests a potential reform of personal taxation in the direction of a comprehensive personal income tax model. How would implementing this hypothetical comprehensive income tax in the existing Serbian tax system change the amount of double taxation? In order to calculate the change in double taxation we will compare the effects of the hypothetical Serbian system with the effects of a hypothetical classical system. We will use hypothetical marginal rates of personal income tax (10%, 15%, 25%, 28%, 33%, 35%), corporate income tax (10%), and withholding tax on dividends (10%). To maintain consistency we have chosen a greater number of rates for personal income tax so we can investigate the effects of different corporate tax systems on different incomes.

Table 5. Comparison of the size of double taxation in a hypothetical Serbian system to the size of double taxation in a hypothetical classical system (in monetary units, if not marked in any other way)

The hypothetical classical system						
The corporation level						
1. The taxable profit of the corporation = 100,000.00						
2. The corporation income tax at the rate of 10% = 10,000.00						
3. The profit meant for distribution = 90,000.00						
The shareholder level						
4. The personal income tax rate	10%	15%	25%	28%	33%	35%
5. The received dividend	90,000	90,000	90,000	90,000	90,000	90,000
6. The amount of personal income tax	9,000	13,500	22,500	25,200	29,700	31,500
7. The total amount of paid taxes (the sum of the two taxes)	19,000	23,500	32,500	35,200	39,700	41,500

8. The effective tax rate for the classical system	19.00%	23.50%	32.50%	35.20%	39.70%	41.50%
9. The increase in the effective tax rate for the classical system compared to the personal income tax rate	90.00%	56.67%	30.00%	25.71%	20.30%	18.57%
The hypothetical Serbian system						
The corporation level						
1. The taxable profit of the corporation = 100,000.00						
2. The corporation income tax at the rate of 10% = 10,000.00						
3. The profit meant for distribution = 90,000.00						
The shareholder level						
4. The personal income tax rate	10%	15%	25%	28%	33%	35%
5. The received dividend	90,000	90,000	90,000	90,000	90,000	90,000
6. The withholding tax on dividends (10%)	9,000	9,000	9,000	9,000	9,000	9000
7. Total amount of paid taxes (the sum of the two taxes)	19,000	19,000	19,000	19,000	19,000	19,000
8. The effective tax rate for the reduced-rate system	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%
9. The increase of the effective tax rate for the reduced-rate system compared to the personal income tax rate	90.00%	26.67%	-24.00%	-32.14%	-42.42%	-45.7%
The change in the amount of double taxation in the hypothetical Serbian system compared to the hypothetical classical system						
The taxation according to the classical system, the relief for dividends or the extra preferential dividend	0%	52.94%	180.00%	225.01%	308.97%	346.15%

Source: Processed by the author.

The data calculated in Table 5 allows the following conclusions:

The lowest income class would be taxed according to the classical system (the reduction in double taxation is 0%). The second income class, which covers the poorer part of the national population, would have its double taxation reduced (dividend relief). The double taxation would be roughly half (52.94%) the size of the double tax in the classical system. The third, fourth, fifth, and sixth income groups would receive an extra preferential dividend. The tax burden of the corporate sector's distributed profit would be less than the tax burden of the non-corporate sector's distributed profits.

We conclude that this hypothetical Serbian system would also have a regressive tax effect; however, the progressive effect would be more evident.

5. AN ENTREPRENEUR OR AN ENTERPRISE?

When the tax content is located at a practical functional level, the final empirical question is established: Does the tax jurisdiction of The Republic of Serbia favour the entrepreneur[1] or the enterprise? Take an individual who owns the resources to start a particular economic activity and is considering the question of the best way to organize the business. Should individual establish an enterprise, or become entrepreneur? The differences in taxation procedures, intensity of tax burden, and effect on profit will be synthesized in five steps:

1) The total income – the total costs = the operating profit.
2) The operating profit = the taxable profit, in accordance with the starting assumptions.

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1 The profit-oriented entities of the developed countries are grouped into two different tax categories. The first tax category is that of 'fiscally transparent entities', which do not pay taxes at the level of the entity (entrepreneur, partnership, S corporation). The second tax category is that of 'real corporations', which are treated as independent subjects in terms of tax jurisdiction, and pay tax on 'their' income at the level of the entity - a separate approach to the taxation of corporate income. Thus individuals and corporations are the two primary entities that pay the corresponding taxes, comprehensive personal income tax and corporation income tax, on the financial results of business activities.
According to Serbian domestic tax jurisdiction (2010, 2011a, 2011b), economic activity can be registered in two different tax categories. Entrepreneur ('fiscally transparent entity') is an individual who performs an activity for the purpose of generating income and is as such registered according to the law. Enterpreneur is a payer of personal income tax. Enterprise ('real corporation') is a payer corporate (enterprise) income tax.

3) The taxable profit – the profit tax = the net profit.
4) The net profit of the entrepreneur = the net profit for distribution (when the entrepreneur is just the payer of the profit tax, i.e., the payer of tax on the income from self-employment).
   The net profit of the entrepreneur – the annual personal (i.e., citizen) income tax = the net profit for distribution [when the entrepreneur is the payer of both the profit tax and the annual personal (i.e., citizen) income tax].
5) The net profit of the enterprise = the net profit for distribution (when there is no double taxation of dividends, i.e., in the case of retaining 100% of profit).
   The net profit of the enterprise – the withholding tax on dividends = the net profit for distribution (when there is a double taxation of dividends, i.e., in the case of distribution of dividends).

1) Let us assume an example of a particular economic activity that is expected to have a total annual income of 15,000,000.00. The structure of the total annual costs (for example, 8,000,000.00 dinars) changes depending on the form of organization of the business (Table 6). The key alternative is the possibility of the owner of the enterprise becoming an employee in the enterprise (further in the text: "the employed owner" of the enterprise), so that his/her annual gross salary is a deductible item recognized as expenses in the tax balance. The entrepreneur does not have this possibility, apart from business trip costs up to the amount allowed in salary taxation. We emphasize the procedural regulation that the entrepreneur cannot reduce the operating profit based on salary.

Table 6. Determinination of the operating profit and taxable profit of entrepreneur and enterprise (annual amounts in dinars, if it is not marked in any other way)

The entrepreneur
1. Total income = 15,000,000
2. Operating costs = 8,000,000
3. Social security contributions = net income x 35.8% = 1,353,404.16 x 35.8% = 484, 518.72
4. Total costs = 8,484,518.72
5. Operating profit = taxable profit = 6,515,481.28
The enterprise
1. Total income = 15,000,000.00
2. Operating costs = 8,000,000.00

3. Net salary = monthly net salary (80,000, for example) x 12 = 960,000.00
4. Salary tax = 12, 595.40 x 12 = 151,144.80
5. Social security contributions charged to the employee = 1,353,404.16 x 17.9% = 242,259. 36
6. Gross salary of the employed owner = 1,353,404.16
7. Social security contributions charged to the employer = 1,353,404.16 x 17.9% = 242,259. 36
8. Total costs = 9,595,663.52
9. Operating profit = taxable profit = 5,404,336.48

Notes to Table 7: Let us assume that the base for counting the contributions, that is, the annual net income of the entrepreneur, is equal to the amount of the annual gross salary of the employed owner of the enterprise, so that the analysis is indifferent to the size of contributions. The assumption is present to deactivate the influence of the size of the social contributions on the concluding comments of the research.
Source: Processed by the author.

2) To provide comparability of the data for entrepreneur and enterprise we will introduce two assumptions. Since the tax bases of the enterprise and the entrepreneur are determined in the same way, the legal regulations that correct the taxable profit will be excluded from the forthcoming analysis (adjustment of income and expenses, determining capital gains and losses, transfer prices, etc.). Since the systems of tax incentives and tax credits are very similar, the subsequent effects of the tax preferences will also be excluded from the forthcoming analysis. This will result in the operating profit and taxable profit being equal (Table 6).

Total annual income reduced by total annual costs equals the annual operating profit, which in our case is equal to the annual taxable profit. The taxable profit of the entrepreneur is higher than the taxable profit of the enterprise (by 1,111,144. 80 din). What are the reasons for the different amounts of taxable profit? Part of the entrepreneur's annual gross salary is not recognized as an expense in the tax balance: annual net salary (960,000.00 din) and annual salary tax (151,144.80 din).

3) In the next procedural step the profit tax is calculated (i.e., the personal income tax is calculated on the income from self-employment) at the proportional rate of 10% (to unify the terms, the "profit" of the enterprise and the "income" from self-employment are used as synonyms). After establishing the profit tax the entrepreneur is in the more favourable position because s/he realises a higher net profit and pays a smaller total amount of tax and contributions, that is, s/he has a

lower level of effective taxation (see: Table 7). We are now in a position to advise the hypothetical individual as follows:

When the entrepreneur is the payer of the profit tax, then the individual should choose to become entrepreneur, because it, according to the criteria of size of profit and tax, represents a more attractive choice.

Table 7. Comparative analysis of the levels of effective taxation after assessing profit tax (annual amounts in dinars, if not marked in any other way)

The entrepreneur
1. Net profit = taxable profit (6,515,481.28) – profit tax (651,548.13) = 5,863,933.15
2. The effective rate of taxes and contributions related to the taxable profit = 17.44%
The enterprise
1. Net profit = taxable profit (5,404,336.48) – profit tax (540,433.65) = 4,863,902.83 dinars = Net profit for distribution
2. The effective rate of taxes and contributions related to the taxable profit = 21.76%

Source: Processed by the author.

4) Is this advice definite and unconditional? No, it is not: the statement is valid only for entrepreneurs that do not pay annual personal income tax, for entrepreneurs who make a smaller net profit than triple the average annual salary per employee paid in the Republic of Serbia (1,898,388.00 dinars for 2011, i.e., 3 x 632,796.00 din. See: The Official Herald of the Republic of Serbia, 6/12). When the net profit is higher than the triple amount limit, such as the example in the current analysis, then the net profit of the entrepreneur constitutes the 'income for taxation'. After levying the annual income tax (Table 8) the comparative tax situations change. The enterprise is in a more favourable position because it makes a bigger profit for distribution (4,863,902.83 din) than the entrepreneur does (4,542,182.34 din) and because it pays a smaller total amount of tax and contributions, i.e., because it has a lower level of effective taxation in relation to taxable profit. The existing effective rate of taxes and contributions for the enterprise, 21.76%, is in the new tax situation, lower than the appropriate tax rate for the entrepreneur, which was increased by the annual tax from 17.44% to 22.9%. We are now in a position to give a second piece of advice to the hypothetical individual:

If the entrepreneur is the payer of both profit tax and annual personal income tax, then s/he should choose to establish an enterprise, because this organisational form is in both a profit- and tax-preferential position.

Table 8. Level of effective taxation of the entrepreneur after assessing annual personal tax (in dinars, if not marked in any other way)

1. The net profit of the entrepreneur = 5,863,933.15
The non-taxable amount = 1,898,388.00
The income for taxation = 3,965,545.15
The personal deductions = 348,037.00
The base for taxation = 3,617,508.15
Up to the amount of 3,796,776, the rate is 10% = 361,750.82
Above the amount of 3,796,776, the rate is 15% = 0
2. The annual personal (i.e., citizen) income tax = 361,750.82
3. Net profit for distribution = 4,542,182.34
4. The effective rate of taxes and contributions related to the taxable profit = 22.99%
5. The effective rate of taxes and contributions related to the net profit for distribution = 32.98%

Note to Table 8: The basis of annual personal income tax is taxable income, represented by the difference between 'income for taxation' and 'personal deductions'. In the presented analysis the personal deductions were calculated for the taxpayer (40% of the average annual salary per employee in The Republic of Serbia) and one dependent (15% of the average annual salary). In order to provide comparability of data it is necessary to introduce the assumption of income equivalence: the entrepreneur, after levying of the annual tax, reduced the net profit for distribution to the annual amount of 960,000.00 dinars; this amount is equal to the annual net salary of the employed owner of the enterprise (960,000.00 dinars).
Source: Processed by the author.

5) For the entrepreneur the policy of profit distribution is irrelevant, because the total amount of net profit, above the non-taxable triple limit, is the subject of annual personal income tax. The policy of profit distribution, however, is an active instrument of the enterprise's decision-making. In the analysis so far we have assumed that the net profit for distribution was not distributed in total. How does the tax treatment of the net profit for distribution influence the tax and profit status of the enterprise and the entrepreneur?

(1) For the entrepreneur the procedure of taxation has finished, but the enterprise, by the act of distribution, is eligible for double taxation. We think that the analytical justification of the distribution policy presumes the answer to the

question of marginal character: What percentage of the enterprise's net profit for distribution can be paid out in the form of dividends and enable the enterprise to realise an identical level of effective taxation, compared to the given level of the effective taxation of the entrepreneur (32.98%, Table 8)? The tax jurisdiction gave the enterprise tax privileged status: the enterprise was able to distribute 87.90% of the net profit, which is an atypically large share and identical to the effective rate of total taxes and contributions for both organisational forms, 32.98% (calculating the effective rate of total tax and contributions, related to the appropriate net profits for distribution, clearly includes all taxes and contributions).

(2) If we zoom in on the comparative effects of the total amount of profit tax and annual tax for the entrepreneur (i.e., if we exclude the entrepreneur's contributions for personal net income from the analysis), and the level of double tax of the enterprise, that is, the total amount of profit tax and withholding tax on dividends (if we exclude the tax and both contributions on the salary of the employed owner of the enterprise from the analysis), the enterprise could 'pay out' an excessive 111.99% of the net profit for distribution, while at the same time the effective rate for both organisational forms is identical (22.31%). The presented data imply one important analytical dimension.

(3) A part of conventional professional wisdom is that a policy of low dividends is the same as a reduction in double taxation. It is frequently stressed that an increase /reduction in the double tax is a function of an increase/reduction in the participation of dividends in the net profit for distribution. This statement is correct, but does not tell the whole story. The alternative dividend policies should be integrated in the flow of the taxation process. It is necessary to compare the size of double tax with the size of the taxes and contributions on the salary of the employed owner of the enterprise and, by varying these two determining tax amounts, to direct the law towards the valorization of the corresponding net tax effect.

The different tax treatment of the salary of the employed owner of the enterprise and of the distributed dividends demands elaboration of the respective tax savings of different combinations of salary level and dividend level. A reduction in the employed owner's salary moves an interactive line of income-cost-profit-tax reactions. Specifically, the initial reduction of salary influences: (i) the reduction of taxes and contributions on the salary, (ii) the reduction of total costs, (iii) the increase of taxable profit, (iv) the increase of profit tax, (v) the increase of withholding tax on dividends and (vi) the increase of net profit for distribution, as a synonym for the increased financial potential to pay dividends. Focusing

on our example, is the effect of the tax saving inherent in the relatively low withholding tax on dividends, calculated in the context of the previously noted chain of tax changes initiated by the reduction of the salary of the employed owner of the enterprise? When we reduce the owner's salary by 20%, and the total amount of the consequent increase in the net profit for distribution is paid out in the form of dividends, what is the net tax effect? The effective rate of the total taxes and contributions of the enterprise is reduced from 34.18% to 30.90%: in other words, the 20% reduction in the salary of the owner (in our example the reduction from 960,000.00 din to 768,000.00 din) equals a 4.18% reduction in the total of paid taxes and contributions (by 69,566.46 din). In the marginal case, when the employed owner does not receive his salary (a reduction of 100% of the salary), the effective rate of the total taxes and contributions is reduced from 34.18% to 21.11% (by 635, 663.52 dinars). We can now give two more pieces of advice to our hypothetical individual:

Minimising the employed owner's paid salary with the aim of maximising the volume of paid dividends and thus making a tax saving is an active instrument of tax planning and decision-making for the enterprise.

Considering the final profit and tax parameters of the enterprise and the entrepreneur (the taxpayer of both profit tax and annual personal income tax), the more favourable option is for the individual to become an employee of the enterprise.

6. CONCLUSION

Corporation income tax and personal income tax are not neutral. The tax regime is full of selective determinations that influence only particular entities or only particular time periods. There is no ideal organisational form that fits all business activities. Each particular case in which the law treats the operating profit differently creates the opportunity for tax planning and changing business behaviour. Managers and owners should structure their businesses in order to control the tax consequences, that is, to minimise the tax burden and maximise tax savings.

In the developed countries the tax status of a business loss differs depending on whether it occurs in a tax transparent entity or a corporation, while in a less developed country such as Serbia the two are positioned at the same tax level.

In the decades at the turn of the 20th there was a global orientation towards a reduction in taxation of capital income, and the developed countries have increasingly moved from diverse forms of the classical tax system to a more homogenous policy of shareholder relief provision. The global trend of reducing the withholding tax rate on dividends has two opposing consequences: it simplifies the tax procedure and reduces taxpayers' subsequent administrative and compliance costs, while the reduced rate has regressive taxation effects. The Serbian tax system has neglected the distributional aims and consequences of taxation.

The analysis of a practical example from the Serbian tax context shows whether the tax system favours the entrepreneur or the enterprise: the level of net profit is the key parameter of ranking. If the net profit of the entrepreneur is less than the triple legal limit, then the entrepreneur is a more attractive organizational form, valorised according to the criteria of the amount of realized profit and paid tax. In all other combinations of levels of net income and active taxes, the enterprise is the more desirable organizational form. For the entrepreneur the policy of profit distribution is irrelevant. For enterprise management, however, the different profit distribution policy combined with the different paid salary policy is an effective instrument to increase business profitability.

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