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## THE LIMITATIONS OF ENTREPRENEURSHIP DEVELOPMENT IN BOSNIA AND HERZEGOVINA WITH SPECIAL EMPHASIS ON TAX REGULATIONS AND PROCEDURES

### ABSTRACT

*Small and medium-sized enterprises account for over 99% of active businesses in Bosnia and Herzegovina, and face a number of limitations when performing their business activities. A number of those limitations relate to the nature of small and medium-sized enterprises, but most are due to the inadequate legal and regulatory framework for doing business. A disincentivised business environment and lack of a unified economic policy and sector strategies further complicate the position of small and medium-sized enterprises. The aim of this paper is to show the limitations faced by these companies. To this end, an investigation involving 119 small and medium-sized enterprises in Bosnia and Herzegovina was conducted.*

*Convenience sampling was used in the research. Based on the survey, it is evident that respondents rated the tax burden factor (the tax structure and taxation process) the most problematic. This finding corresponds with Doing Business' 2019 survey results.*

*A section of this paper is devoted to the fiscal aspect of doing business: tax regulations and the overall tax burden and taxation procedures. It shows that the magnitude of the fiscal burden, the complexity of tax regulations and the inconsistency and complexity of the taxation system are a significant burden on small and medium-sized enterprises. The paper concludes with recommendations for more efficient and simpler tax regulation.*

**Key words:** *Small and medium-sized enterprises, barriers to business success, tax regulations.*

**JEL:** *M13, M48, L26, K34*

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## 1. INTRODUCTION

According to their number and share in the gross domestic product of nation states, small and medium-sized enterprises (SMEs) dominate the global economy. This is also true in Bosnia and Herzegovina, where small and medium-sized enterprises make up over 99% of active companies and create more than 60% of the gross domestic product. Because of this, they are the focus of our research. This paper presents the characteristics of small and medium-sized enterprises, with special emphasis on internal and external constraints.

Our study of the limitations and obstacles encountered by small and medium-sized enterprises was carried out on 119 such businesses in the Federation of Bosnia and Herzegovina. The respondent inter alia cited the legal framework, unfair competition, and the size of the domestic market as significant limitations to doing business. But they rated tax liability their biggest obstacle (i.e. the taxation structure and tax burden), which corresponds to Doing Business' 2019 survey results. In this regard, particular attention is paid to fiscal constraints and the burden of tax liability. The existence of four separate tax systems creates different tax environments in different parts of B&H, and the complexity of the system and the tax regulations places a significant burden on taxpayers. This burden also contributes to tax evasion in B&H.

The paper is comprised from six chapters. It starts with a selected review of literature on small and medium enterprises. Then it provides a theoretical view of the definitions, characteristics, advantages and limitations of small and medium-sized enterprises in the world and in B&H. The state of entrepreneurship and its environment in B&H, according to the Global Competitiveness Report and the Doing Business Indicators is provided in third Chapter. Subsequently, the constraints and obstacles faced by sample of 119 SMEs in the Federation of Bosnia and Herzegovina, are presented. Since both mentioned research have shown that the burden of tax liabilities and procedures is the biggest problem for SMEs, the fifth chapter is devoted to the tax system and the burden of tax liability. The sixth chapter contains suggestions for improving the tax system in order to provide support to small and medium-sized enterprises.

## 2. Literature review

Because of their representation and participation in the creation of GDP, small and medium-sized enterprises are the generator behind the development of national economies, as noted by well-known economists such as Michael E. Porter<sup>4</sup> and Joseph

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4 For more information see: Porter, M. E, 1998. *The Competitive Advantage of Nations*, Free Press, ISBN12-9780684841489

Schumpeter.<sup>5</sup> German authors Berthol, Kullas, Neumann,<sup>6</sup> Carree and Thurik<sup>7</sup>, as well as American authors Robbins, Pantousco and Fuller<sup>8</sup> have also contributed to the aforementioned findings regarding the developmental role of small and medium-sized enterprises in the United States and the developed countries of the European Union.

Berthold et al.<sup>9</sup> confirm that there is a positive correlation between the number of (newly established) enterprises, rates of self-employment, and economic growth. Carree and Thurik<sup>10</sup> demonstrate that the share of small firms in manufacturing industries in Europe in 1990 had a positive effect on the growth of industrial output. Thurik has shown that the rapid growth of small companies has had a positive impact on GDP growth rates in sixteen European countries over the period 1988-1993. Carree<sup>11</sup> used as an example the five strongest global economies (France, Germany, Japan, UK and USA) to prove that countries whose manufacturing industries recorded a smaller shift to small businesses in the period 1977-1990 had lower rates of growth.

By analyzing the results for 48 US states in the period 1986-1995, Glaeser et al.<sup>12</sup> and Robbins et al.<sup>13</sup> proved that states with a large share of (very) small businesses had a higher level of productivity growth and GDP growth over the aforementioned period.<sup>14</sup>

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- 5 For more information see: Schumpeter, J., 1934. *The Theory of Economic Development*, Cambridge: Harvard University Press
  - 6 Berthol, N, Kullas, M., and Neumann, M. (2007) "Wie motiviert man Unternehmertum in Deutschland?" *Wirtschaftsdienst*, Vol 87, Iss.12, pp. 818-823.
  - 7 Carree, M. A., i Thurik, A. R. (1998) „Small firms and economic growth in Europe“, *Atlantic Economic Journal*, 26(2), pp.137-146.
  - 8 Robbins, K., Pantousco, F., and Fuller, K. (2000) "An Empirical Assessment of the Contribution of Small Business Employment to U.S. State Economic Performance", *Small Business Economics*, pp. 293-302.
  - 9 Berthol, N, Kullas, M., i Neumann, M. (2007), op. cit, p. 818-523.
  - 10 Carree, M. A. & Thurik, A. R. (2002). „The Impact of Entrepreneurship on Economic Growth“, *International Handbook of Entrepreneurship Research*, pp. 1-27.
  - 11 Carree, M. A. (2002), „Industrial restructuring and economic growth.“, *Small Business Economics*, 18. Kluwer Academic Publishers, Netherlands, pp. 243-255.
  - 12 Glaeser, E. L., Kallal, H. D, Scheinkman, J. A & Shleifer, A. (1992). *Growth in Cities*. *Journal of Political Economy*, 100, pp. 1126-1152.
  - 13 Robbins, K., Pantousco, F. & Fuller, K. (2000), „An empirical assessment of the contribution of small business employment to U.S. state economic performance“, *Small Business Economic.*, 15, 293-302.
  - 14 For more information see: Martinović, D. & Veselinović, Lj. (2018). „Da li nivo poduzetničke aktivnosti i indeks TEA predstavljaju pokazatelje ekonomskog rasta?“, *BH Ekonomski forum*, Vol 8, No 1, p.13

However, the development role of small businesses is limited by a series of internal and external factors. Barriers related to the nature of small and medium-sized enterprises, as well as to business conditions and regulatory and other factors, limit their performance. These limiting factors are particularly pronounced in transitional countries. In his study on problems faced by SMEs in 119 developing and transitional countries, Wang<sup>15</sup> concludes that financing is the most significant.

In their research, Ur Rehman et al<sup>16</sup> conclude that SMEs in the Western Balkans most often face problems related to finance, tax rates, tax administration, corruption, an inadequately educated labor force, competition from the informal sector, and political instability. Taxation rates and structures are a predominant limiting factor, both in transitional and developing countries. This is shown in Gemmel et al's<sup>17</sup> current research, which studies SMEs from 11 European countries and discovers that high taxes reduce the productivity of a company. Bond and Xing<sup>18</sup>, analyzing the sectoral panel data for the USA, Japan, Australia and seven EU countries from 1982 to 2007, conclude that profitability indicators have a strong negative correlation with the level of taxation. Similarly, following Italian company data for the period 1994 to 2006, Federica and Paris<sup>19</sup> determined that high direct taxes disincentivize a company's investment. Since the level of direct taxes has a negative impact on various indicators of business performance, there is a trend in the EU to reduce the level of individual taxes that burden business operations, while simultaneously expanding the tax base to achieve a neutral tax effect for state budgets.<sup>20</sup>

The success of the company in addition to tax rates (the amount of tax liability) is also influenced by tax administration and tax procedures. In order to successfully fulfill their tax obligations, small business owners must be familiar with laws, tax

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15 Wang, Y. (2016). „What are the biggest obstacles to growth of SMEs in developing countries? – An empirical evidence from an enterprise survey“, *Borsa Istanbul Review*, Volume 16, Issue 3, pp. 167-176.

16 Ur Rehman, N., Çela, A., Morina, F & Sulčaj Gura, K. (2019), „Barriers to growth of SMEs in Western Balkan countries“, *Journal of Management Development*, Volume 38, Issue 1, pp. 2-24

17 Gemmel, N. , Kneller, R., McGowan, D., Sanz, I. & Sanz-Sanz, J.F. (2019), „Corporate Taxation and Productivity Catch-Up: Evidence from European Firms“, *Scandinavian Journal of Economics* Volume 120, Issue 2, pp. 372-399.

18 Bond, S. & Xing, J. (2015). „Corporate taxation and capital accumulation: Evidence from sectoral panel data for 14 OECD countries“, *Journal of Public Economics*, Volume 130, pp. 15-31.

19 Federici, D. & Parisi, V. (2015) „Do corporate taxes reduce investments? Evidence from Italian firm-level panel data“, *Cogent Economics and Finance*, , Volume 3, Issue 1

20 Bräutigam, R., Spengel, C. & Stutzenberger, K. (2019), „The development of corporate tax systems in the European union from 1998 to 2017: Qualitative and quantitative analysis“, *Intertax*, Volume 47, Issue 6-7, pp. 536-562

regulations and procedures. Haber and Reichel<sup>21</sup> believe that “taxation is a specific part of the general human potential of entrepreneurs, which increases the chances of business success.” Essential knowledge of tax obligations and procedures is hampered by the fact that tax legislation is perceived more complex than legislation regulating other business areas (Carnes and Cuccia)<sup>22</sup> and the fact that it is very often changing (Chittenden et al.)<sup>23</sup>. The need for a stable regulatory framework and the simplification of tax procedures is highlighted by a number of authors (Burke and Gallery<sup>24</sup>; Joumard<sup>25</sup>; Molan<sup>26</sup>).

Filling out tax returns requires some knowledge from small business owners and causes expenses expressed in money and time. The collection of internal data from the enterprises necessary for completing the tax return, the procurement of the necessary literature that deals with tax issues, the process of filling out a tax return, the engagement of an external expert or contacts with the tax administration in order to obtain information or corrections of tax returns represent a significant amount of time and money spent by the taxpayer. This is a significant burden especially for small business owners<sup>27</sup>.

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- 21 Haber, S. and Reichel, A. (2007), “The cumulative nature of the entrepreneurial process: the contribution of human capital, planning and environment resources to small venture performance”, *Journal of Business Venturing*, Vol. 22 No. 1, pp. 119-45.
  - 22 Carnes, G.A. and Cuccia, A.D. (1996), “An analysis of the effect of tax complexity and its perceived justification on equity judgments”, *The Journal of the American Taxation Association*, Vol. 18 No. 2, pp. 40-56.
  - 23 Chittenden, F., Kauser, S. and Poutziouris, P. (2005), “PAYE-NIC compliance costs – empirical evidence from the UK SME economy”, *International Small Business Journal*, Vol. 23 No. 6, pp. 635-56.
  - 24 Burke, L. i Galler, K (2011). „Achieving optimum balance in the simplification of tax compliance obligations for business customers and management of compliance and collection risks by revenue“, *Proceedings of the European Conference on e-Government, ECEG2011, Pages 124-131, 11th European Conference on e-Government, ECEG 2011; Ljubljana; Slovenia; 16 June 2011 through 17 June 2011.*
  - 25 Joumard, I. (2002), “Tax systems in European Union Countries”, *OECD Economic Studies*, , Vol. 34, pp. 91-151
  - 26 Molan, P. (2007). „Service delivery-simplifying tax administration for individuals and business“, *Proceedings of the European Conference on e-Government, ECEG2007, Pages 349-357, 7th European Conference on e-Government, ECEG 2007; Den Haag; Netherlands; 21 July 2007 through 22 July 2007*
  - 27 Chittenden, F., Kauser, S. and Poutziouris, P. (2003), “Tax regulation and small business in the USA, UK, Australia and New Zealand”, *International Small Business Journal*, Vol. 21 No. 1, pp. 93-115.

Education of small business owners in the field of tax regulations shows that greater knowledge in the field of tax laws and procedures increases their ability to properly declare tax liability but also increases their readiness and willingness to report tax. The stated evidently influences the reduction of tax evasion (Kamleitner et al)<sup>28</sup>.

### 3. Small and Medium-Sized Enterprises: A Theoretical Presentation of Characteristics, Potentials and Constraints

Economic literature and legal regulations use various definitions of small and medium-sized enterprises. As a classification criterion in European Union countries, the number of employees, annual income and value of assets are taken into account. Small companies have fewer than 50 employees and an annual income of less than 10 million euros, and medium-sized enterprises employ up to 250 people, have an annual income of less than 50 million euros, and an asset value of up to 43 million euros. Micro-enterprises are a special category of small enterprises, and have less than 10 employees and an annual income of less than 2 million euros.<sup>29</sup> In the United States and Japan, besides an enterprise's number of employees and the size of its income/assets, the affiliation of a company to a particular industry is an important criterion for classification.

Accordingly, depending on the industry, small and medium-sized enterprises in the United States can have between 100 and 1,500 employees and an annual turnover ranging from 1.5 million to 20.5 million euros.<sup>30</sup> In Japan, small enterprises in the production sector have up to 300 employees and equity of up to 50 million yen (\$135,000), and those in trades and services have up to 50 employees and up to 10 million yen (\$26,000) in equity.<sup>31</sup> Even within Bosnia and Herzegovina there is no unique definition of small and medium enterprises; in the absence of a unifying state law, entity laws treat this issue differently.

According to the RS Law on the Development of Small and Medium-Sized Enterprises,<sup>32</sup> small enterprises employ fewer than 50 people, have a revenue of less than

28 Kamleitner, B., Korunka, C. i Kirchler, E. (2012), "Tax compliance of small business owners: A review", *International Journal of Entrepreneurial Behaviour & Research*, Vol. 18 Iss: 3 p. 338

29 European Commission, (2012). *The New SME Definition. User Guide and Model Declaration*, p.14

30 For more information, see: Karmel, S. M., and Bryon, J. A., 2002. *Comparison of Small and Medium Sized Enterprises in Europe and in the USA*. London: Routledge, p. 21

31 Petković, S., and Berberović, Š., 2013. *Ekonomika i upravljanje malim i srednjim preduzećima, Principi i politike*. Banja Luka: Ekonomski fakultet, p. 11

32 Narodna skupština Republike Srpske, 2013. *Zakon o razvoju malih i srednjih preduzeća RS*. [online]. Available at: <http://www.narodnaskupstinars.net/?q=la/akti/usvojeni-zakoni/zakon-o-razvoju-malih-i-srednjih-preduze%C4%87> [Accessed 15 December 2018]

2 million BAM per year and hold an average value of assets of less than 1 million BAM; and medium-sized enterprises have between 50 and 250 employees, an income of between 2 and 8 million BAM, and assets valuing less than 4 million BAM. Micro-enterprises have less than 10 employees. The FB&H Law on Incentives for Small Businesses<sup>33</sup> uses other categories to determine the size of the enterprise: the amount of turnover, and the value of the balance sheet. Under this categorisation, micro-companies have fewer than 10 employees, and the value of their balance sheet is less than 400,000 BAM; small companies employ fewer than 50 people and have an annual turnover of less than 4 million BAM; medium-sized enterprises employ up to 250 people, have an annual turnover of less than 40 million BAM, and the value of their annual balance sheet is up to 30 million BAM.

This role is closely related to the nature and characteristics of these enterprises with regard to the advantages they have over larger companies.

Small and medium-sized enterprises are characterised by their flexibility in adapting to market changes and end-user demands; their flexibility in choosing business and market niches; their simpler and more flexible organisational structures; their more efficient use of material resources and workforces; their efficient and fast communication with their external and internal environments; their greater motivation and more approachable human resource management, which create a more intimate work environment; and their facilitated communication and sharing of ideas and information. A much smaller investment is required for the establishment and operation of small and medium-sized businesses.<sup>34</sup> According to Džafić (2006)<sup>35</sup> advantages of small and medium-sized enterprises compared to large companies are their innovativeness, their small entry capital, their lower investment per employee, job creation, lower costs, easier organisation and control, connectivity, and a stronger sense of belonging to a collective. The importance of these characteristics in the development of transitional countries is emphasised in a series of surveys.<sup>36</sup>

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33 Vlada Federacije Bosne i Hercegovine. 2006. Zakon o poticanju razvoja malog gospodarstva/ male privrede FBiH (Službene novine FBiH 19/06 od 19. 04. 2006.) [online]. Available at: <http://www.fbihvlada.gov.ba/bosanski/zakoni/2006/zakoni%20registar%202006>. [Accessed 17 May 2019]

34 For more information see: Martinović, D. (2014) "Privredni razvoj - politike malih i srednjih poduzeća" Vanjskopolitička inicijativa BH, Fond otvoreno društvo BiH, Sarajevo, pp. 1-5

35 Džafić, Z., (2006). *Preduzetnička ekonomija – Mala i srednja preduzeća u funkciji restrukturiranja tranzicijskih privreda*. Tuzla: Denfas, p. 81

36 Aidis, R., i Sauka, A., (2005). "Assessing Moving Targets: Analyzing the Impact of Transition Stages on Entrepreneurship Development", *Ekonomika*, 69, ISSN 1392-1258, pp. 1-21.



In addition to these benefits, however, small and medium-sized enterprises are faced with some internal weaknesses and limitations. Authors Corman and Lussier<sup>37</sup> cite their inadequate managerial abilities, inadequate funding, and poor competitive position.

Business practice has shown that small and medium-sized enterprises encounter limitations in terms of low levels of knowledge about new technologies, problems accessing funding, weak negotiating power, low productivity, a lack of entrepreneurial skills, and a lack of knowledge of staff management. In small and medium-sized enterprises, the owner of a company is often its manager, leader and organiser, and can also be engaged in procurement and sales, marketing, and financial management.

Most business owners do not have the specialised knowledge for this, or the range of entrepreneurial skills required. Consequently, as a business grows it is impossible for one person (the owner) to carry out every crucial task. We often encountered an inadequate division of work in small and medium-sized enterprises, accompanied by the lack of a strategic approach to planning, especially regarding long-term activities, identifying and implementing strategic and action plans, and outlining short- and long-term goals. There was a clear lack of vision and long-term orientation in terms of where the business is today, where it wants to be in the future, and how to accomplish this.

It was established that incompetent management of small and medium-sized enterprises around the world is the main cause of their failure.<sup>38</sup> The deficiencies of small and medium-sized enterprises include: greater susceptibility and vulnerability to market fluctuations and disturbances: greater exposure to seasonal and other fluctuations in sales; lower adaptability and competitive responsiveness; a greater risk of financial exposure and other business risks that result in illiquidity and a high level of debt. Small firms, due to their internal weaknesses, on average have less debt, are less export oriented, have less desire to grow, apply formal management and planning techniques less frequently, receive fewer incentives from the state, and often fail<sup>39</sup>.

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37 Corman, J., and Lussier, R. N., (1996). *Small Business Management: A Planning Approach*. USA: Irwin, pp. 8-9

38 For more information see: Dostić, M., (2002). *Menadžment malih i srednjih preduzeća*. Sarajevo: Ekonomski fakultet Univerziteta u Sarajevu.

39 Pojam i značenje malih i srednjih poduzeća. Available at: [www.agr.unizg.hr](http://www.agr.unizg.hr) [Accessed 18 December 2017]

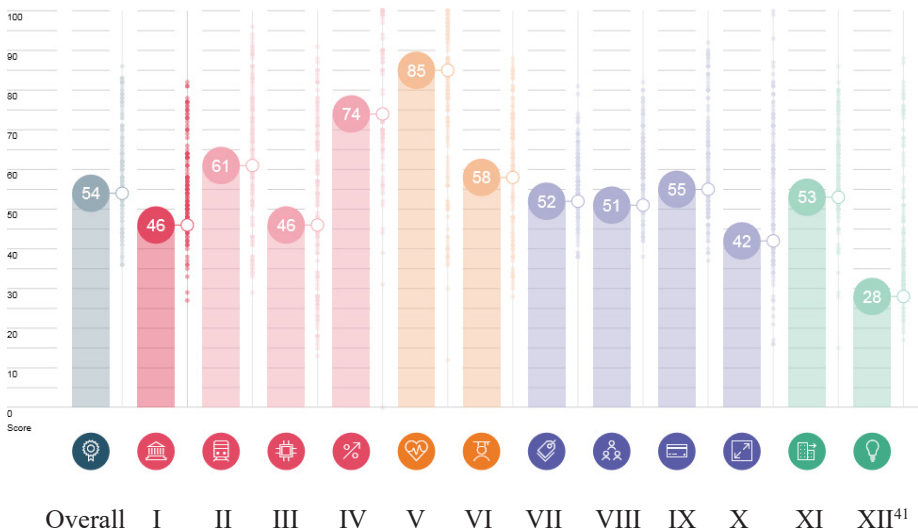


#### 4. Entrepreneurship in Bosnia and Herzegovina in the Context of the Global Competitiveness Report and Doing Business Indicators

Bosnia and Herzegovina has not created legal-regulatory and institutional prerequisites to support the small and medium-sized enterprise sector. The general business environment is not stimulating to entrepreneurship, as evidenced by Bosnia and Herzegovina's rank in the Global Competitiveness Report and its rating based on the Doing Business Indicators.

According to the Global Competitiveness Report, B&H came 91st out of 140 countries in 2018. Its biggest obstacles to achieving competitiveness fell under Pillar 1 (Institutions), 111th place); Pillar 2 (Infrastructure), 89th place; Pillars 7 and 8 (Product Market and Labour Market), 106th and 109th place respectively; and Pillars 11 and 12 (Business Dynamism and Innovation Capability), 106th and 114th place respectively. Bosnia and Herzegovina's performance according to the Global Competitiveness Index for all 12 Pillars of Competitiveness is shown in Figure 1.<sup>40</sup>

**Figure 1:** Global Competitiveness Index for B&H (Performance):



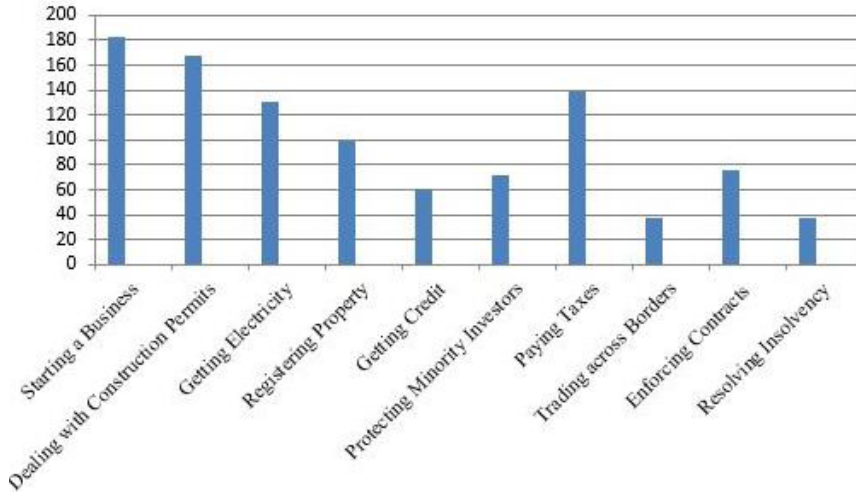
**Source:** *World Economic Forum, The Global Competitiveness Report 2018, Economy Profiles, Bosnia and Herzegovina*

<sup>40</sup> The range is from 0 to 100, with 0 the worst rating (lack of performance) and the 100 best.

<sup>41</sup> Pillar 1: Institutions; Pillar 2: Infrastructure; Pillar 3: Information and Communication Technology Adoption; Pillar 4: Macroeconomic Stability; Pillar 5: Health; Pillar 6: Skills; Pillar 7: Product Market; Pillar 8: Labour Market; Pillar 9: Financial system; Pillar 10: Market Size; Pillar 11: Business Dynamism; Pillar 12: Innovation Capability.

According to the Doing Business Indicators, B&H ranked 89 out of 190 countries in 2019. This rank is explained in Figure 2.<sup>42</sup>

**Figure 2:** B&H's Rank Based on Doing Business Indicators:



*Source: World Bank, Training for Reform, Doing Business 2019, Bosnia and Herzegovina, page 4*

Figure 2 shows that Bosnia and Herzegovina ranks worst in the areas of issuing building and other permits (167th place), and taxation and tax regulations (139th place).

## 5. Restrictions on Small Entrepreneurship in Bosnia and Herzegovina

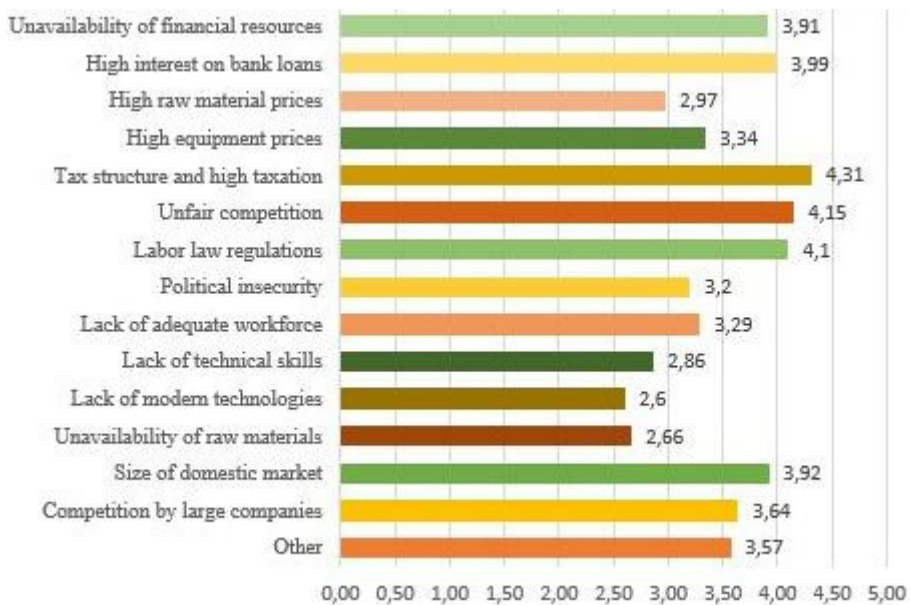
In order to identify the determinants of independent entrepreneurial venture creation in Bosnia and Herzegovina as constraints on the development of its small entrepreneurship, we surveyed owners and initiators of such ventures. We used a convenience sample for our research, which, based on the analysis of 119 completed questionnaires, covered: the main determinants of entrepreneurial motivation in B&H (i.e. factors affecting an entrepreneur's decision to start a business); the main barriers to start-ups and business development; and the role of the state in small entrepreneurship. This non-probability sampling technique was applied because it is fast, inexpensive, easy and the subjects are readily available.

Listed below are some of the most significant barriers to starting and developing a small business. Respondents' ratings are based on subjective assessment and are graded on Likert's five-tier scale, where 1 means "completely disagree" and 5 means

<sup>42</sup> Rankings are from 1 to 190, with 1 being the best-rated country for business startups and 190 the worst.

“completely agree”. The study looked at the price and availability of financial resources, the burden of tax regulations and tax liabilities, raw material and fixed asset prices, competition, lack of adequate workforce skills and modern technologies, and political uncertainty. Figure 3 shows 14 barriers along with the average response for each.

**Figure 3:** Barriers to the Development of Small Entrepreneurship



**Source:** Senita Mašić, *Determinants for Starting Independent Entrepreneurial Ventures in Bosnia and Herzegovina*, School of Economics and Business Sarajevo, May 2018, p. 88

Based on the survey, it is evident that respondents rated tax liability their biggest obstacle (i.e. the taxation structure and tax burden), which corresponds to Doing Business' 2019 survey results.

Respondents also cited the legal framework with reference to the Labour Law, unfair competition, and the size of the domestic market as significant limitations to doing business. The lack of adequate financial resources and their high cost (e.g. interest on bank loans) were also identified as a significant obstacle to setting up and running a small business. Respondents identified the lack of modern technologies and the (un) availability and high cost of raw materials as the least significant problems.

## 6. The tax system, taxation procedures and SMEs in B&H

Doing Business and the Tax Duty Indicator (“Tax Duties”) show that in B&H, tax liability is payable 33 times annually, which requires 411 hours (for the preparation of data, and completion and submission of tax forms) and amounts to 23.7% of profits.<sup>43</sup> Most countries in Europe and Central Asia require fewer than half the number of payments (16.6 on average), and just over half the number of hours to prepare and pay taxes (214.8 hours). Developed OECD countries require only a third of the number of tax payments and a third of the time needed for the payment of taxes in relation to Bosnia and Herzegovina.

Table 1 gives a comparative overview of the tax payment indicators in B&H, European and Central Asian countries, the most developed OECD countries, and the best ranked countries according to the Doing Business Indicators.

**Table 1:** Tax Payments

Indicator	Bosnia and Herzegovina	Europe & Central Asia	OECD high income	Best Regulatory Performance
Payments (number per year)	33	16.6	11.2	3 (Hong Kong SAR, China)
Time (hours per year)	411	214.8	159.4	49 (Singapore)
Total tax and contribution rate (% of profit)	23.7%	32.3%	39.8%	26.1% (32 economies)

**Source:** *World Bank, Training for Reform, Doing Business 2019, Bosnia and Herzegovina, page 38.*

The Doing Business Tax Accounting Indicator monitors two aspects of tax liability: the liability itself (tax rate), and the technical elements of its fulfillment (the number of payments made, and the amount of time spent preparing data for completing tax forms and filing them with the tax office). Our focus will be on the latter – the technical aspects of tax liability – which are closely related to the taxation procedures and the tax system as a whole in B&H.

The large amount of time (and therefore money) spent fulfilling tax obligations is an indication of the complexity and unresponsiveness of the tax system in B&H, and of the country’s unjustified taxation procedures.

<sup>43</sup> World Bank, Training for Reform, Doing Business 2019, Bosnia and Herzegovina

The tax system in B&H is a “hybrid system, a very complex system with a complex fiscal structure and a split of tax jurisdiction.”<sup>44</sup> The existence of “four separate tax systems”<sup>45</sup> (one at the state level, two at entity level, and one in Brcko District) is compounded by the lack of interconnection between them. The inconsistency of taxation policy creates different tax environments in different parts of B&H, and the complexity of the system and the tax regulations places a significant burden on taxpayers. This burden also contributes to tax evasion in B&H. “Due to a lack of systematic data from the tax system, tax controls are too superficial, reactive and focused, mainly with an emphasis on the formal arrangement of transactions and transaction verification. Taxpayers can be subject to multiple-party controls at the same time.”<sup>46</sup>

Because of their size, their lack of expertise, and their technical and personnel constraints, small and medium-sized enterprises are more sensitive than larger companies to the frequent changes to tax regulations, the inconsistency of taxation procedures, and the complexity and non-interconnection of the tax system.

The complexity of the tax system in B&H was verified in a 2015 survey of 100 owners and managers of small and medium-sized enterprises. Of these respondents, 63% believed that the tax system is complicated, and half (51%) considered it extremely complicated; 75% agreed that the non-compliance of tax regulations at entity level and in Brcko District had a negative impact on their business outcomes. Respondents stated a desire for: the improvement of tax legislation (89%); more clarity and a precise definition of tax liabilities (82%); better co-operation with tax administrations (83%); and systematic solutions to simplify the process of taxpaying. They also named as problems: frequent changes to the law; impropriety and lack of regulation; legislative inequality; the large number of taxation procedures; tax relief problems; and poor taxation procedures for small and medium-sized enterprises.<sup>47</sup>

The non-compliance of taxation procedures, the overall state regulation of small and medium-sized (and new and growing) companies, and their significant tax burden were also determined within the GEM survey in B&H. “Government policy, as a framework for entrepreneurial frameworks, has been rated as one of the three worst preconditions with regard to the disincentive component of the entrepreneurial environment in the country in each of the last four years in which Bosnia and Herzegovina participated in the GEM project.

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44 Terzić, S., (2017). “Poreski sistem u Bosni i Hercegovini”, *Ekonomski izazovi*, godina 6, broj 12, decembar 2017, p. 72

45 Ibid

46 Terzić, S. (2017), op. cit., p. 78

47 Aldžić, E., (2015). *Uticaj poreznog sistema na konkurentnost malih i srednjih preduzeća u Federaciji BiH*. Sarajevo: Ekonomski fakultet Univerziteta u Sarajevu, p.110-117

This includes aspects of concrete policies, priorities and support, as well as regulations and taxes, which regulate the business environment for entrepreneurship.<sup>48</sup>

The study of 119 companies shows that: legislation in B&H is not stimulating to the establishment and development of private businesses; and the quality of the institutional infrastructure is not adequate to support small businesses, as the implementation of economic policy measures to strengthen small and medium-sized enterprises is not considered a government activity.

The results of the survey by respondents' average rating are shown in Table 2.

**Table 2:** Government policy and Independent Entrepreneurial Endeavors in B&H

Question	Number of questionnaire	Average rating
Legislation in B&H is stimulating to the establishment and development of private businesses	119	2.4
The quality of the institutional infrastructure in your company's environment is very high	119	2.9
Bosnia and Herzegovina's economic policy stimulates the faster development of small businesses	119	2.5

*Senita Mašić, Determinants for Starting Independent Entrepreneurial Ventures in Bosnia and Herzegovina, School of Economics and Business Sarajevo, May 2018, p. 95*

Interestingly, the level of tax liability and the quality of state regulation and taxation procedures were also assessed as poor in the comparative GEM study by experts in other countries in the region: Croatia, Slovenia, North Macedonia and Montenegro.<sup>49</sup>

The aforementioned is testimony to the need for changes to state regulations and taxation procedures and their better adaptation to the needs of small and medium-sized enterprises, in accordance with the Small Business Act and the Charter on Small Enterprises.

## 7. Proposals for Improving Taxation Procedures and Tax Obligations for Small and Medium-Sized Enterprises: The European Experience

The need for changes to state regulations and taxation procedures, and their better adaptation to the needs of small and medium-sized enterprises in accordance with the Small Business Act and the Charter on Small Enterprises, has been established not only in transitional countries but also in EU member states.

48 Umihanić, B., Tulumović, R., Omerović, M., Simić, S., and Markuš, R., (2012). *GEM BiH, Global Entrepreneurship Monitor, globalni monitor poduzetništva, Poduzetničkim obrazovanjem do (samo)zapošljavanja mladih*, Tuzla: ED Centar za razvoj poduzetništva, p. 74

49 Ibid

The results of the research published in the studies *Simplified Tax Compliance Procedures for SMEs*<sup>50</sup> and *Tax Compliance Costs for SMEs*<sup>51</sup> show that 23 million small and medium-sized enterprises in the EU are faced with complex tax legislation, and often complicated taxation procedures. The regulatory burden is doubled for micro-enterprises (companies with up to 10 employees) compared to that of companies with more than 20 employees, and three times higher than that of companies with 20 to 50 employees.<sup>52</sup>

The high cost of collecting data on the submission of tax returns is a result of: frequent changes to tax legislation; the complexity of the tax system, which is mainly tailored to large companies; the existence of different (and numerous) tax services and institutions; an unclear taxation law; short and non-flexible deadlines for the payment of tax liabilities, resulting in cash flow problems; significant costs related to the engagement of tax consultants and the taxation procedure itself.<sup>53</sup>

The results of the aforementioned research in the EU and B&H show that it is necessary to create a tax system based on the “thinking small first” principle, which would mean creating a predictable, clear and accessible tax system.

Predictability implies a stable and predictable tax environment, with changes to tax regulations made only rarely.

Clarity implies simplified and clear tax procedures and laws. In B&H, it is necessary to harmonise legal regulations and tax systems at entity level. Clarification would contribute to simplified tax registration and payment procedures for small and medium-sized enterprises, and simplified tax forms.

Accessibility would involve greater cooperation with tax administrations and the creation of a user-friendly environment for the needs of small and medium-sized enterprises. The provision of adequate information and expert assistance in the preparation and delivery of tax returns by the tax authorities is of crucial importance. The focus should be on preventing mistakes and cultivating an affirmative, rather than punishing relationship, and the information available on the tax administration web site should be clear and complete. Additionally, electronic tax reporting would reduce the time and money spent for SMEs.

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50 European Commission. (2015) *Simplified Tax Compliance Procedures for SMEs*, Brussels, [online]. Available at: <https://publications.europa.eu/> [Accessed 17 May 2019]

51 European Commission (2018) *Tax Compliance Costs for SMEs*, Brussels, November 2018, [online]. Available at: <https://publications.europa.eu/> [Accessed 17 May 2019]

52 *Simplified Tax Compliance Procedures for SMEs*, European Commission, 2015, p. 5

53 *Simplified Tax Compliance Procedures for SMEs*, op. cit, p. 6



The studies Simplified Tax Compliance Procedures for SMEs and Simplified Tax Compliance Procedures for SMEs propose the establishment of a one-stop shop: a place where companies can get all the necessary information regarding taxes and tax liability. It is also conceivable that this one-stop shop could be used to establish and register small businesses, making it a unique service essential to the establishment and operation of SMEs.

## 8. CONCLUSION

Because of their flexibility, efficiency and small starting capital, small and medium-sized enterprises are the generators of the development of national economies. To allow these businesses to achieve their full potential, the state must create adequate legal and regulatory prerequisites to support them. Unfortunately, the Global Competitiveness Report and the Doing Business Indicators, shown that this is not the case in Bosnia and Herzegovina. This was also confirmed for the sample of 119 small and medium-sized enterprises used for research purposes in this study. Our analysis of those 119 SMEs examined the determinants of entrepreneurial motivation, the obstacles for business start-ups, and the role of the state in small entrepreneurship. Research subjects were mostly dissatisfied with the existing legal framework, the availability and cost of financial resources, and the level of market development. The companies surveyed identified the tax burden (taxation structure and rates) as the most significant impediment, but also mentioned other factors that constitute significant obstacles to doing business. The tax burden is also rated as the biggest obstacle in the current Doing Business Survey for 2019. Because of their size, lack of expertise, and technical and personnel constraints, small and medium-sized enterprises are more sensitive than larger companies to frequent changes to tax regulations, the inconsistency of taxation procedures, and the complexity and lack of interconnection of the tax system.

The creation of a tax system in accordance with the requirements of the Small Business Act, the Charter of Small Enterprises, and the principle of “thinking small first” means the creation of a predictable, clear and accessible tax system. Predictability requires a stable and predictable tax environment, with changes to tax regulations made only rarely. Clarity implies clear, harmonised and simplified taxation procedures. Availability means more cooperation and support from tax administrations, and the creation of a user-friendly environment for the needs of small and medium-sized enterprises.

Further research could test the issues raised in this study across a larger representative sample of SMEs. Thus, it would be particularly beneficial to expand this study using in-dept interviews to test its findings. This study might also be extended other transition economies, especially ex- Yugoslavia countries to determine whether the findings of this research are unique to BiH or robust across those economies, taking into consideration different institutional contexts.

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## OGRANIČENJA U RAZVOJU PODUZETNIŠTVA U BOSNI I HERCEGOVINI SA POSEBNIM OSVRTOM NA POREZNE REGULATIVE I PROCEDURE

### SAŽETAK

*Mala i srednja preduzeća koja čine preko 99% aktivnih preduzeća u Bosni i Hercegovini susreću se sa nizom ograničenja u svom poslovanju. Određeni broj ograničenja je uslovljen samom prirodom malih i srednjih preduzeća no većina ograničenja je vezana za neadekvatan pravno-regulatorni i institucionalni okvir za poslovanje. Nestimulativno poslovno okruženje i nepostojanje jedinstvene ekonomske politike i sektorskih strategija dodatno usložnjavaju položaj malih i srednjih preduzeća. U fokusu ovog rada je prikaz ograničenja sa kojima se susreću ova preduzeća. U svrhu prikaza i analize istih provedeno je istraživanje na 119 malih i srednjih preduzeća u Bosni i Hercegovini. U istraživanju je korišten namjerni uzorak a rezultati su obrađeni primjenom deskriptivne statistike. Na temelju istraživanja evidentno je da su ispitanici najlošije ocijenili faktor poreske obaveze – poreske strukture i namete, što korespondira sa rezultatima istraživanja Doing Businessa za 2019. godinu.*

*Poseban dio rada je posvećen fiskalnom aspektu poslovanja – poreznim regulativama i prikazu cjelokupnog tereta poreznih obaveza i poreznih procedura. Visina ukupnog fiskalnog opterećenja, složenost poreznih propisa te neusklađenost i kompleksnost cjelokupnog poreznog sistema predstavljaju značajno opterećenje za vlasnike malih i srednjih preduzeća. Na kraju rada date su preporuke za efikasniju i jednostavniju poreznu regulaciju.*

**Ključne riječi:** mala i srednja preduzeća, poslovne barijere, porezne regulative

**JEL:** M13, M48, L26, K34