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TAX BENEFITS OF R&D IN CRISIS CIRCUMSTANCES - ACCOUNTING ASPECTS

Abstract: In times of crisis, one of the major challenges for businesses is maintaining an appropriate level of liquidity. During periods marked by supply and/or demand shocks caused by various economic, political, or natural influences, most companies experience a drop in sales and a decreased likelihood of collecting receivables on time, if at all. In conditions of reduced business activity and lower cash inflows from operations, businesses are forced to seek additional sources of liquidity to ensure their survival despite the crisis. Tax reliefs can serve as a means for companies to secure additional liquidity sources, i.e., a way to reduce the costs they face. This paper primarily explores the possibility of reducing cash outflows related to gross wages paid. One form of tax relief available to companies in the Republic of Serbia is for research and development (R&D) activities. If a company decides to engage in R&D activities, it will pay a lower amount of taxes and contributions for employees involved in these activities, thereby saving funds and improving its liquidity. The paper presents which activities are considered R&D according to the legal and sub-legal regulations of the Republic of Serbia and the conditions necessary for a company to benefit from tax reliefs. Additionally, the paper discusses the accounting aspect of calculating wages for employees engaged in R&D activities**.**

Keywords: Research and Development (R&D), innovations, tax reliefs, liquidity.

1. INTRODUCTION

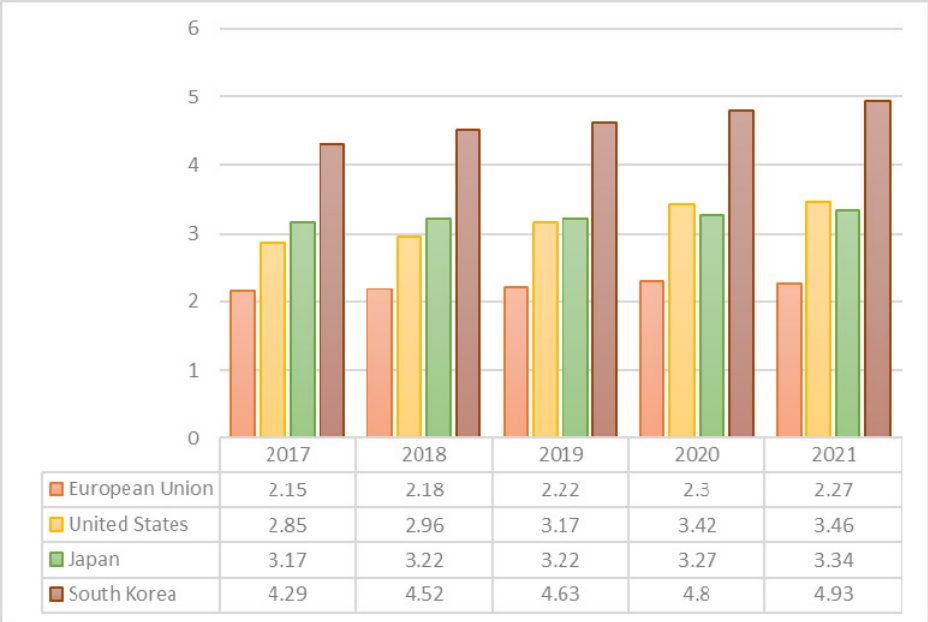
In the 21st century, R&D activities are considered key factors that can ensure growth and development at the level of companies, regions, countries, and the entire world. By creating new knowledge and successfully applying it through innovation, productivity, competitiveness, a higher number of jobs, and greater economic growth are achieved (Dajić, 2017). The intense pressure of globalization, reflected in a strong competitive battle, creates a constant need for innovation. Acquiring knowledge and skills in modern conditions of intensified competition becomes an important goal both at the individual and societal level (Kovačević, 2019). Innovations are essential not only in creating new products and services but also in defining new business processes to achieve faster, more efficient production at the lowest possible costs without compromising the quality of new products. The highly dynamic modern environment leads to various crises caused by economic, political, war, and economic shocks. Crisis periods are characterized by a decrease in market demand, leading to a drop in sales volume, revenue, while costs increase, further reducing financial results. Most companies face liquidity problems and the challenge of maintaining an optimal amount of cash to meet obligations to the state, creditors, suppliers, and employees. Authors who have explored ways for companies to quickly overcome crisis situations agree on the necessity of early crisis detection. In crisis conditions, the ability to quickly adapt to changes and to innovate is of paramount importance. Many countries, aiming to achieve better global competitive positions, recognize the importance of R&D activities in this endeavor and try to steer companies towards R&D through tax reliefs, reduced tax rates, and providing grants for project co-financing, etc. Besides the introduction and conclusion, the paper is divided into three main sections. The first section highlights the importance of R&D activities at the macro level and Serbia's position relative to selected countries in the region and the world in terms of

the percentage of gross domestic product spent on these activities. The second section covers the importance of innovative actions by companies, focusing on one of the fundamental problems, especially for small and medium-sized enterprises, regarding the financing of these activities. The third section addresses one of the Republic of Serbia's incentive measures for conducting R&D activities, reflected in tax reliefs on wages generated from R&D activities. In times of crisis, companies can utilize tax reliefs, thus reducing the cost of R&D activities through savings on taxes and contributions on wages, directly improving their liquidity position. This can enable them to generate innovations through R&D more quickly, potentially allowing them to emerge from a crisis and possibly even use the crisis conditions to gain a competitive edge.

2. THE IMPORTANCE OF RESEARCH AND DEVELOPMENT ACTIVITIES AT THE MACRO LEVEL

The impact of knowledge on economic growth was first mentioned in the mid-20th century by the economist Robert Solow, who expanded the growth model with a technological variable. Solow observed that the growth of gross domestic product per capita in the USA during the period from 1909 to 1949 was driven by a 12.5% increase in capital, while the remaining 87.5% was due to technical progress (Kecman, 2016). Solow belonged to the theorists of the neoclassical theory of economic growth, who considered knowledge as a public good (Tomljanović, 2017). Further discussions on the importance of investing in R&D for economic growth emerged in the 1980s and 1990s within the framework of the endogenous economic growth model. Endogenous theorists attributed market characteristics to knowledge, with key features being rivalry and exclusivity (Tomljanović, 2017). Romer stated that an increase in production directly depends on the amount of labor involved in R&D activities (Tomljanović, 2017). Griliches focused on the social rate of return on investments in R&D, stating that the social rates are significantly higher compared to the private rates of return on capital invested in R&D (Kecman, 2016). In today's model of economic growth, innovation plays a primary role and represents a significant factor in sustainable development (Mitrović&Mitrović, 2020). Authors Pecić and Petrović (2022) consider innovations and technologies as the heart of social progress, noting that societal advancement has significantly accelerated with each new invention since the beginning of the world. Countries that best and most quickly adapt to changes through the development of new innovations are also the most successful countries (Filipović, Nikolić & Ilić, 2015). In a highly globalized world with intense competition among nations, individual countries aim to achieve long-term competitiveness through the development of a knowledge-based economy (Filipović et al., 2015). R&D activities play a crucial role in the development of science, technology, and innovations, which are fundamental principles for the growth and development of countries (Jakšić & Trajković, 2023). Recognizing the importance of R&D for gaining a competitive edge, the European Union set a goal with the Lisbon Strategy adopted in 2000 to become the most competitive and dynamic knowledge-based economy in the world by 2010. To achieve this goal, the European Council set a target of investing 3% of the gross domestic product in R&D (Jakšić & Trajković, 2023). Countries with the highest incomes are those that invest the largest percentage of their gross domestic product in R&D (Jakšić & Trajković, 2023).

Chart Number 1: Percentage of Research and Development in the GDP Structure in European Union Countries, USA, Japan, and South Korea from 2018 to 2021

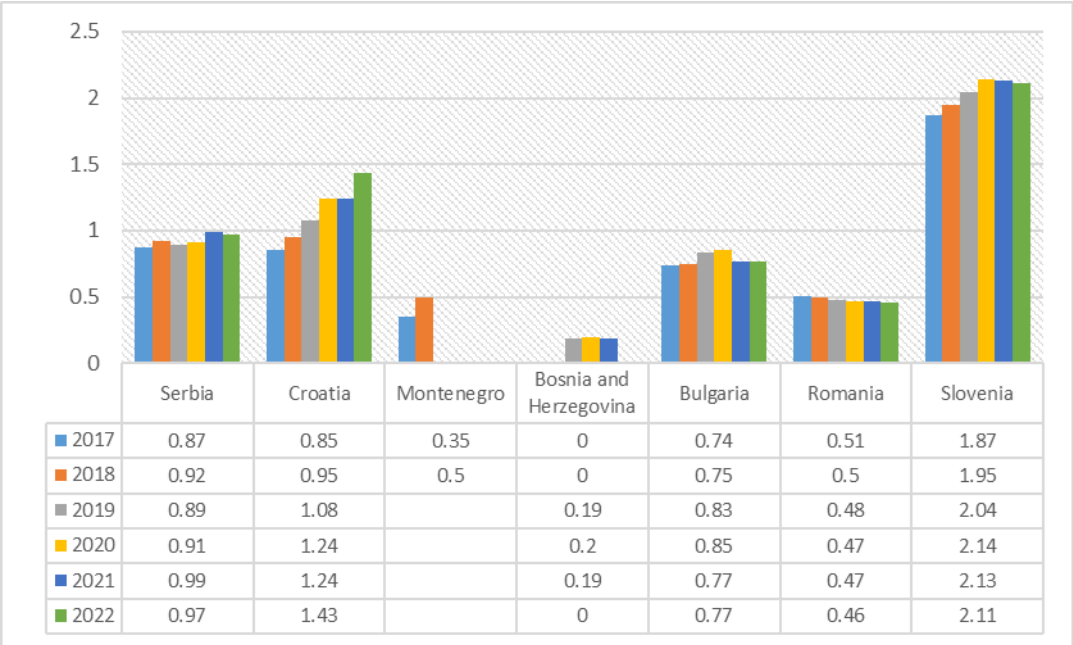


	2017	2018	2019	2020	2021
European Union	2.15	2.18	2.22	2.3	2.27
United States	2.85	2.96	3.17	3.42	3.46
Japan	3.17	3.22	3.22	3.27	3.34
South Korea	4.29	4.52	4.63	4.8	4.93

Source: Developed by the author based on Eurostat

Some of the most developed countries in the world invest over 3% of their GDP in R&D activities, which makes them global leaders in innovation and holders of long-term competitive advantages among nations. The Council of the European Union has set a target of investing 3% of GDP in R&D activities. Some members, such as Germany, Austria, and Sweden, invest even more than 3%, but certain member countries have significantly lower R&D expenditures, which affects the decrease of this indicator at the level of the European Union and the failure to achieve the target of 3% R&D participation in GDP.

Chart Number 2: Percentage of Research and Development in the GDP Structure in Serbia and Selected Western Balkan Countries



	Serbia	Croatia	Montenegro	Bosnia and Herzegovina	Bulgaria	Romania	Slovenia
2017	0.87	0.85	0.35	0	0.74	0.51	1.87
2018	0.92	0.95	0.5	0	0.75	0.5	1.95
2019	0.89	1.08		0.19	0.83	0.48	2.04
2020	0.91	1.24		0.2	0.85	0.47	2.14
2021	0.99	1.24		0.19	0.77	0.47	2.13
2022	0.97	1.43		0	0.77	0.46	2.11

Source: Developed by the author based on Eurostat

The chart shows that Slovenia stands out among the selected surrounding countries with the highest percentage of GDP allocated to R&D activities in all observed periods, followed by Croatia from 2019, while Serbia currently allocates less compared to these two countries but significantly more compared to Bulgaria and Romania. There are no available data for Montenegro and Bosnia and Herzegovina for all selected years, and the available data indicate that these two countries allocate a significantly smaller percentage of GDP to R&D compared to other countries in the region. Authors Jovetić and Janković (2012) conclude that the share of research and development in GDP has a statistically significant impact on the movement of gross domestic product per capita, i.e., if the share of R&D in GDP increases by 1% (decreases by 1%), the gross domestic product per capita will increase (decrease) by about 0.5%. In times of crisis and significant societal challenges, as confirmed by the crisis caused by the COVID-19 pandemic, it is very important for countries to respond quickly through the innovation system to prevent a decline in employment and living standards (Pecić & Petrović, 2022). Considering indicators such as the Global Competitiveness Index, it can be concluded that countries that develop innovative business methods, have highly productive business processes, and possess quality scientific research institutions have reached the highest level of economic development and achieved an enviable competitive position at the global level (Lazić & Markov, 2011). From all the above, it can undoubtedly be concluded that R&D activities are one of the key factors for economic growth, improvement of the competitive position at the global level, and enhancement of the living standards of the population. On the world market, the most competitive countries are those that efficiently utilize the resource of knowledge (Nikolić, Stošković & Cvetanović). A competitive economy operates within a large number of successful companies, where there is full employment and which provides a sustainable high standard of living (Filipović et al., 2015).

3. THE IMPORTANCE OF RESEARCH AND DEVELOPMENT ACTIVITIES IN COMBATING CRISIS AT THE COMPANY LEVEL

Companies are forced to think proactively and constantly strive to create innovations to ensure their long-term survival and development. Entities undertake R&D activities to increase their product offerings and improve the efficiency of production processes through cost reduction (Aralica, 2011). Companies rely on innovations because they create new markets and build competitiveness (Pecić & Petrović, 2022). R&D activities, in most cases, require not only an innovation-oriented organizational structure and the engagement of highly competent individuals but also significant financial capital, which companies, especially small and medium-sized enterprises, find increasingly difficult to secure

in crisis conditions. Factors influencing the degree of innovativeness of a company can be grouped into organizational and financial factors (Ravić & Gavrić, 2015). Small and medium-sized enterprises are characterized as the most vital and flexible part of the national economy, with high levels of flexibility, developed entrepreneurial spirit, focus on creativity, absence of rigid regulations and procedures (Ravić & Gavrić, 2015). All these characteristics of small and medium-sized enterprises indicate that they are the most capable in the economy to quickly adapt to changes and pivot towards innovating products, services, and processes, but such companies often lack financial resources for R&D. With an increasing number of participants in the global market and strong competitiveness, no organization can be assured of security and permanence, and the time frames for adapting to changes are becoming shorter (Bečić & Dabić, 2007). In a turbulent business environment, companies may face various conditions that lead to a crisis, manifesting in reduced earning capacities. Besides the challenges brought by global and regional crises, companies can also face significant dangers from their individual crises, i.e., circumstances that lead to the worsening of situations in a particular company. Some early signs of a crisis include a decrease in orders from customers and a loss of market share, which will result in a drop in sales volume, profits, and company liquidity (Pešević, 2013). Successful companies possess methods and tools that allow them to timely recognize a crisis, prevent it, and manage it, resulting in crises occurring less frequently, being of shorter duration, and having milder consequences in such companies (Milojević, 2011). In periods when a company's sales volume drops and its earning capacity decreases, one of the first and biggest problems is maintaining the necessary level of cash to meet obligations, i.e., maintaining an adequate level of liquidity. A liquidity crisis is reflected in a situation where a company is unable to meet its due financial obligations within their due dates or is unable to meet them at all (Pešević, 2013). Identifying the causes of a crisis before its effects become visible is crucial for timely action (Vojnović, Vojnović & Grujić, 2011). Fundamentally, a crisis is considered a danger, but it can also represent an opportunity (Krstić & Krstić, 2016). If a company promptly recognizes the onset of circumstances that may threaten its operations and if it directs all available resources towards improving its processes through innovative activities, not only can it avoid losses, but it can also achieve a competitive position. Competition is one of the primary drivers that compel a company to improve existing products and introduce new ones, and the ability to innovate is a result of learning and development (Milojević, 2011). In contemporary business conditions, innovative action by companies is considered a necessity if they wish to survive in the market and achieve growth and development. Crisis conditions actually highlight the need for R&D, but companies often face a lack of financial resources for R&D in crisis situations, so state assistance can be of great significance.

4. TAX INCENTIVES AS A MOTIVATION FOR CONDUCTING R&D AND A WAY TO IMPROVE LIQUIDITY IN CRISIS SITUATIONS

A competitive economy operates within a large number of successful companies, where there is full employment and which provides a sustainable high standard of living (Filipović et al., 2015). Governments, in their desire to achieve competitiveness among other countries and due to the positive externalities that R&D activities have on society, decide to introduce various measures such as tax incentives for such activities to further motivate companies to engage in them. Countries wishing to encourage the conduct of research and development activities in companies may also decide to reduce the tax rate on R&D activities. For instance, Belgium introduced a reduced tax rate from 34% to 6.8% for innovation production in 2007, Luxembourg reduced the tax rate from 30.4% to 5.9% in 2008, and the United Kingdom reduced the tax rate from 30% to 24% (Pecić & Petrović, 2022). The Government of the Republic of Serbia strives to support all companies by reducing their fiscal burden in the form of taxes and contributions on wages generated from engaging employees in R&D activities, making it easier for them to decide to conduct R&D as it will reduce the costs of gross wages. In crisis conditions, companies can use these incentives to achieve developmental business goals with lower labor costs, without reducing the number of employees and their net wages, thus remaining a reliable employer. A company crisis can be defined as a process in which the basic economic goals of the company are threatened, including the goal of preserving invested capital, the goal of profitability, and the preservation of liquidity and solvency of the company (Pešević, 2013). Reduced gross wage costs, especially in a crisis situation, affect lower cash outflows from business activities, which certainly improves the liquidity position and frees up funds that can be redirected to meet obligations to other creditors, thus reducing the deterioration of the credit position that often occurs when a company faces a crisis. The effects of an economic crisis are reflected in a decrease in purchasing power, a reduction in demand, increased operating costs, increased business risks, resulting in reduced investments, layoffs, and company closures (Ravić & Gavrić, 2015). In addition to improving liquidity through the conduct of R&D activities, a company can more quickly improve its competitive position. In contemporary conditions, a company's competitiveness should be built on innovations, the development of new ideas, processes, and production processes; innovativeness is one of the most significant factors for the survival, growth, and development of a company (Ravić & Gavrić, 2015). If a company is innovation-oriented and invests resources in R&D activities, it often emerges from a crisis situation much faster than other companies that do not engage in R&D. In addition to the assumption that a company will more easily gain a competitive advantage through research and development, using tax incentives can save significant funds that would otherwise be spent on paying taxes and contributions on wages, as shown in a practical example later in this paper. Article 53z of the Law on Contributions for Mandatory Social Insurance exempts employers who are legal entities and

conduct research and development activities in the territory of the Republic of Serbia from the obligation to pay contributions for mandatory pension and disability insurance for the wages of individuals directly engaged in R&D activities, in the amount of 100% of the obligation, proportional to the time they spend on R&D activities relative to full-time work. Article 21i of the Law on Personal Income Tax exempts the employer-legal entity from the obligation to pay 70% of the calculated and withheld income tax on the wages of individuals engaged in R&D activities, proportional to the time they spend on R&D activities relative to full-time work. The Regulation on the Conditions and Manner of Exercising the Right to Tax Exemption on the Wages of Employees Engaged in Research and Development ("Official Gazette of RS", No. 48/22) specifies the conditions that must be met for a company to enjoy such benefits. According to the Regulation that specifies the manner and conditions for exercising the right to this type of tax incentives, research and development are considered activities "developing new or improving existing production systems and/or products, developing new or improving existing computer circuits, formulating new chemical compounds, developing new or improving existing systems for solving soil and environmental pollution problems, evaluating soil characteristics, conducting laboratory experiments, developing software solutions, developing waste water management systems, developing new or improving existing materials, and similar".

The paper presents an example that will practically demonstrate the significance of tax incentives as a determinant of liquidity in a company. The assumptions guiding the author in creating the example are as follows:

- The employer pays a gross wage of 200,000 Serbian dinars to an employee who was engaged in R&D activities 50% of the working time relative to total working time;
- The amount of the non-taxable part of wages as of January 1, 2024, in the Republic of Serbia is 25,000 Serbian dinars, according to Article 15a, paragraph 2 of the Law on Personal Income Tax;
- Article 44 of the Law on Contributions for Mandatory Social Insurance specifies the percentages from the gross wage that are allocated for pension and disability insurance contributions, health insurance contributions, and unemployment insurance contributions;
- According to Article 16 of the Law on Personal Income Tax, wages are taxed at a rate of 10%;
- The employer separately calculates the part of the wage related to R&D activities and does not pay pension and disability insurance contributions for these activities, neither on behalf of the employee nor the employer, and pays income tax at 30% of the calculated tax on the wage related to R&D activities.

Table 1 Presentation of the calculation of the part of the total gross wage related to activities not considered research and development

Ordinal number	DESCRIPTION	Amount
1	Gross earnings of the employee for research and development work	100,000.00
2	Non-taxable amount (25,000 * 50%)	12,500.00
3	Tax base (Line 1 - Line 2)	87,500.00
4	Income tax (Line 3 * 10%)	8,750.00
5	Base for contributions (Line 1)	100,000.00
6	Contribution for Pension and Disability Insurance (on employee's burden) (Line 5 * 14%)	14,000.00
7	Contribution for Health Insurance (on employee's burden) (Line 5 * 5.15%)	5,150.00
8	Contribution for Unemployment Insurance (on employee's burden) (Line 5 * 0.75%)	750.00
9	Net earnings of the employee	71,350.00
10	Contribution for Pension and Disability Insurance (on employer's burden) (Line 5 * 10%)	10,000.00
11	Contribution for Health Insurance (on employer's burden) (Line 5 * 5.15%)	5,150.00
12	Tax exemption (Line 4 * 70%)	6,125.00
13	Employer-paid income tax (Line 4 - Line 11)	2,625.00
14	Contributions for Pension and Disability Insurance paid by the employer	0.00

Source: Developed by the author

Based on the presented example, we can conclude that the employer will allocate a total of 115,150.00 RSD (line no. 4+line no. 6+line no. 7+line no. 8+line no. 9+line no. 10+line no. 11) for the payment of net salary and all corresponding taxes and contributions on the part of the salary not related to research and development.

Table 2 Presentation of the calculation of a portion of the total gross earnings related to research and development activities

Ordinal number	DESCRIPTION	Amount
1	Gross earnings of the employee for performing other tasks.	100,000.00
2	Non-taxable amount (25,000 * 50%)	12,500.00
3	Tax base (Line 1 - Line 2)	87,500.00
4	Income tax (Line 3 * 10%)	8,750.00
5	Base for contributions (Line 1)	100,000.00
6	Contribution for Pension and Disability Insurance (on employee's burden) (Line 5 * 14%)	14,000.00
7	Contribution for Health Insurance (on employee's burden) (Line 5 * 5.15%)	5,150.00
8	Contribution for Unemployment Insurance (on employee's burden) (Line 5 * 0.75%)	750.00
9	Net earnings of the employee	71,350.00
10	Contribution for Pension and Disability Insurance (on employer's burden) (Line 5 * 10%)	10,000.00
11	Contribution for Health Insurance (on employer's burden) (Line 5 * 5.15%)	5,150.00
12	Tax exemption (Line 4 * 70%)	0.00
13	Employer-paid income tax (Line 4 - Line 11)	8,750.00
14	Contributions for Pension and Disability Insurance paid by the employer	24,000.00

Source: Developed by the author

Based on the presented example, we can conclude that the employer will allocate a total of 85,025.00 RSD (the sum of items with line nos. 7, 8, 9, 11, 13) for the payment of net wages and all associated taxes and contributions for wages related to R&D activities. By comparing these two calculations, we can conclude that the company will have a smaller outflow of funds amounting to 30,125.00 RSD for the part of the wage related to research and development compared to the part of the wage related to tasks not considered as research and development. In other words, the company saved 26% of the total gross wage cost on the portion of the gross wage generated from R&D. If the company had a total gross wage cost for all employees of 20 million RSD and if each employee spent 50% of their working time on research and development, the company would save 2,615,153.00 RSD due to lower paid taxes and contributions on wages just for one month, which could amount to approximately 31.4 million RSD in savings over a year.

CONCLUSION

R&D, as activities that will result in an innovated or entirely new product, service, or business process, are an inevitability in the business of the modern world, as such activities are one of the key conditions for securing a competitive advantage. The business environment is turbulent and changes rapidly, and companies are expected to be capable of quick reactions. In addition to the significance of innovative processes for companies, countries also want to increase the scope of research and development activities at the national level to secure a competitive advantage over other countries. Besides greater competitiveness, it is considered that a larger scope of research and development influences an increase in the gross domestic product per capita, which certainly affects the improvement of the standard of living in countries that engage more resources for R&D. Governments of countries introduce various programs to encourage companies to invest in R&D, and one way to achieve greater motivation for companies for R&D is through tax incentives on wages paid for engaging in R&D activities. Especially in crisis conditions, it is important for companies to actively work on innovations as it is assumed that this will enable them to overcome crisis situations more quickly, which are primarily reflected in a decrease in demand for their products and services. By using benefits in the form of reduced taxes and contributions on wages, they will also have lower outflows of funds based on wages, allowing them to direct a larger portion of funds towards meeting obligations to other creditors, i.e., improving their liquidity position. The author's intention is to emphasize the importance of R&D activities both at the macro level and at the company level and to interest companies in using the benefits in the form of reduced gross wage costs paid for R&D activities, which can impact the improvement of the company's liquidity position.

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Law on Contributions for Mandatory Social Insurance ("Official Gazette of RS", Nos. 84/2004, 61/2005, 62/2006, 5/2009, 52/2011, 101/2011, 7/2012 - harmonized din. amounts, 8/2013 - harmonized din. amounts, 47/2013, 108/2013, 6/2014 - harmonized din. amounts, 57/2014, 68/2014 - other law, 5/2015 - harmonized din. amounts, 112/2015, 5/2016 - harmonized din. amounts, 7/2017 - harmonized din. amounts, 113/2017, 7/2018 - harmonized din. amounts, 95/2018, 4/2019 - harmonized din. amounts, 86/2019, 5/2020 - harmonized din. amounts, 153/2020, 6/2021 - harmonized din. amounts, 44/2021, 118/2021, 10/2022 - harmonized din. amounts, 138/2022, 6/2023 - harmonized din. amounts, 92/2023 and 6/2024 - harmonized din. amounts.)

Regulations on the conditions and manner of exercising the right to tax exemption based on the earnings of employees engaged in research and development ("Official Gazette of RS", No. 48/2022)