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Tax Reforms in Republic of Macedonia: 2006-2014

1. Introduction.

Republic of Macedonia had faced a number of challenges and difficulties since declaring its independence (September 8th 1991, Independence Day of Macedonia), pursuing a political and economic reform aimed to build a democratic society and open market economy. One of the most important challenges was the need of new tax policies, which would replace those inherited from socialist regime, designed to promote economic growth through the expansion of private enterprises.

In view of the role of taxation as one of the key elements for successful global economic reforms, the task of designing a new tax system and reforming the tax administration gained high priority on Government's agenda of post-independence Republic of Macedonia. The main objectives of the first tax reform of 1993 were to create a modern tax system, consistent with an open market economy, to be: (a) efficient in ensuring stable and optimal amount of public revenue for financing the supply of public goods; (b) internationally comparable and competitive; (c) simple for application and "difficult" for evasion; and (d) flexible, in terms of immediate reaction to changing economic conditions. These objectives were to be achieved through wide implementation of the *neutrality principle* in the domain of taxation, to the contrary of the former tax system, which relied heavily upon built-in non-neutrality's, and followed, rather unsuccessfully, the philosophy of fiscal *interventionism*.

The new fiscal system is based on market principles, private property, competitiveness, modernization of the system and orientated toward convergence to the European Union. The new tax system from 1993/94 introduced the following types of taxes, typical to modern tax systems: income taxes (corporate income tax and personal income tax), consumption taxes (VAT, excises, custom duties etc.) and property taxes (property tax, tax on inheritance and gift, tax on real estate turnover). New important principle was the repeal of the higher number of contributions and their replacement with taxes. Only the

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** Teaching and research assistant, University "SS Cyril and Methodius", Department of Financial Law, Faculty of Law "Iustinianus Primus", bul. Goce Delcev 9b, 1000 Skopje, Republic of Macedonia, phone: +389 70 688 557, e-mail: elena_neshovska@yahoo.com.

contributions for social funds were kept i.e. the contributions for health, pension and disabled insurance. It was promoted also the principle of transferring the tax burden from direct to indirect taxes, which meant reduction of the income taxes and increasing the consumption taxes. In this function it was also the introduction of the Value Added Tax (VAT), from 1st of April 2000, replacing the previous Turnover Tax.

2. Legal framework of the current Macedonian tax system.

As previously mentioned, the main taxes, now, applicable in the Republic of Macedonia are: personal income tax, profit tax, property taxes, VAT, excises, and customs. The current Macedonian tax system is a centralized system in terms of collection of fiscal and quasi-fiscal levies, the last, radio and TV fee.

2.1 Personal income tax (PIT).

The Law on Personal Income Tax (Off. Gaz. RM no. 80/93 as amended no. 80/93, 70/94, 71/96, 28/97, 8/01, 50/01, 52/01, 2/02, 44/02, 96/04, 120/05, 52/06, 139/05, 160/07, 159/08, 20/09, 139/09, 171/2010, 135/2011, 166/2012, 187/2013 and 13/2014) regulates the tax liability of natural persons, or of individuals. The revenues made by the citizens, in country and abroad, are being taxed with the Personal Income Tax (hereinafter: PIT). PIT is paid annually for the sum of the net revenue from all sources, except for the revenues that are tax exempt by this Law. A taxpayer for the PIT is:

- Resident of Republic of Macedonia - a citizen who makes revenue in country and abroad (world income principle);
- Non-resident of Republic of Macedonia - a citizen who makes revenue on the territory of the Republic;
- Sole proprietor;
- Citizen who performs agricultural, handicraft activity and a person who provides services or free activities, that is not considered being a merchant (notary, lawyers, executors, professors, artists, priests etc.);
- Citizen who performs activities unregistered and makes revenues that are subject to taxation.

An individual is a resident of the RM if he or she has a permanent or temporary residence in the RM. An individual is considered to be resident in the RM if he or she is present in the RM either continuously or with interruptions for 183 or more days in any 12-month period. Taxable income is computed in a way that all income – except tax-exempt income – is aggregated, and then personal allowance is deducted as well as social security contributions and other taxes, and a flat tax rate is applied.

Generally, the following types of income received by individuals are subject to personal income tax:

Personal earnings (salaries and allowances arising from employment, performance based remuneration (for example, bonuses) and fringe benefits; pensions; income realized by members of

management and supervisory boards of enterprises; income realized by officials, members of parliament, advisers and similar high-level persons; income realized by professional sportsmen; sick-leave allowances; annual leave allowances; allowances for judges and jury members, forensic experts and receivers not employed by the respective institutions or enterprises; compensation and remuneration paid to the members of the Macedonian Academy of Sciences and Arts; salaries earned and paid abroad based on employment contracts with Macedonian employers; income derived from rendering services under contracts with entities and individuals on a temporary or occasional basis);

Self-employment income (income from the following types of activities: business activities; professional and other intellectual services; agricultural activities; other activities with the objective of realizing revenues);

Income from property and property rights (income earned through the lease or sublease of land, residential or business premises, garages, leisure and recreational premises, equipment, transportation vehicles and other types of property);

Income from copyrights and industrial property rights (payments received for the use of, or the right to use, such items);

Investment income (dividends and other income realized through participations in the profit of legal entities and noncorporate entities; interest on loans granted to legal entities and individuals; interest on bonds or other securities. Interest on time savings and other deposits are exempt from taxation to the date of the accession of the Republic of Macedonia to the European Union.);

Capital gains (income realized through sales of shares of capital and real estate. Capital gains realized from the sale of securities are not taxable from 1 January 2013 to 31 December 2015);

Gains from games of chance and other prize games (each amount of gain exceeding MKD 5,000 from games of chance and other prize games);

Other revenues (any income that is not specifically mentioned in the Personal Income Tax Law as being exempt from tax is other income, of which 65% is taxable. Other income includes income realized by acquiring securities and equity shares without consideration if the income is not taxed under the law on property taxes. For such income, the basis for the calculation of the tax is 100% of the market value on the day of the acquisition).

Exempt income generally includes the following types of income:

- interest on demand deposits, term deposits and current accounts, as well as interest under securities issued by the Republic of Macedonia or local self government;
- disability pensions;
- scholarships granted by government bodies and registered non-for profit organizations;
- per diem allowances for business trips within the approved limits;

- specific type of rewards;
- compensation for a period of unemployment;
- children allowances;
- certain types of income received on the basis of insurance contracts; and
- certain types of compensation provided under the Labour Relationships Law of the Republic of Macedonia.

In addition, salaries of employees at a taxpayer operating in a technological industrial developing zone are exempt from PIT for a period of 10 years after the commencement of activities in the zone. Thirty per cent of the capital gains from the sale of immovable property, securities and equity participations are exempt from personal income tax, i.e. PIT is due on 70% of the realized gain.

2.2 Corporate income tax (CIT).

All legal persons conducting registered activities in Macedonia are liable for profit tax. Similarly to the *Personal Income Tax Law*, a distinction has been made between resident and non-resident taxpayers. Accordingly, residency of companies is to be determined under the "place of incorporation and registered seat" criteria. Under the Law on Profit Tax (Off. Gaz. RM no. 80/93 as amended no. 33/95, 43/95, 71/96, 28/98, 11/01, 2/02, 44/02, 51/03, 120/05, 139/06, 160/07, 122/08, 159/08, 85/10, 47/2011, 135/2011, 79/2013 and 13/2014) taxpayer of CIT is:

Legal entity (entity) – Resident of Republic of Macedonia that gains profit by performing activity in the country and abroad.

Taxpayer of the Corporate Income Tax is also a permanent establishment of non-resident for the profit realized by performing activity on the territory of the Republic of Macedonia.

Legal entity is a Macedonian resident for tax purposes if it is established or has headquarters on the territory of the Republic of Macedonia.

The generally accepted concept is that resident companies should be taxed on their worldwide income (i.e. the gross income realized from their regular business activities in domestic and foreign countries). Since April 2011, the tax base is defined as a sum of the taxable expenses (or payments subject to income tax) and the underestimated revenues. The first category, and that is "taxable expenses" refers to those expenses that are not excluded from taxation which actually form the tax base. By definition, it is considered that taxable expenses are not primarily connected with the firm's regular business activities and therefore are subject to income tax. The second category, "underestimated revenues", refers to the transactions between connected legal and individual entities. The difference between the gross earnings book value and the tax on taxable expenses and underestimated revenues is subject of additional tax only in the case of distribution of the earnings (in a form of dividends or other forms of income

distribution), when a withholding tax of 10% is applied. If the difference is negative, then a loss after taxes is generated, and in that case tax entities have a legal right to carry it forward in the next 5 (five) years.

Some of the major taxable items include (the list is not all inclusive):

- Expenses not related with the taxpayer's business activities;
- Payments for employment-related expenses, such as: food and transportation, business trip expenses, use of a private vehicle for business purposes, severance payments, retirement allowance etc. exceeding prescribed limits;
- Monthly personal allowances for executive and non-executive directors in the amount exceeding fifty per cent of the monthly average salary, as well as the total amount of the insurance premiums;
- Voluntary pension contributions exceeding four average monthly salaries per employee on an annual basis;
- Donations exceeding 5% and sponsorships exceeding 3% of total revenues;
- Hidden distributions of profits which include providing goods or services at prices below arm's length to shareholders or parties related to them, including lower interest rates on loans granted, unjustified shortages, etc;
- Interest expenses on loans falling under the thin capitalisation rules (refer below for more details);
- Withholding tax, borne as a cost by a Macedonian taxpayer;
- 90% of entertainment expenses.

2.2.2 The flat tax system in the Republic of Macedonia.

The Government of Macedonia introduced a number of supply-side policy measures at the end of 2006 aiming to reduce the tax burden and improve the business environment. The main pillars of the tax system reform were the elimination of the progressive system of personal income tax, the reduction and unification of the statutory rates for the personal income and corporate taxes, and introduction of zero tax rate on reinvested profits. The so called flat tax refers to personal income and corporate profits being taxed at one marginal rate (12% in 2007 and 10% in 2008 onwards). The Macedonian system of flat taxation was introduced in 2006 by amending the Law on Personal Income Tax from January 31 2006 and the Law on Profit Tax also from January 31 2006. Specifically, with the amendments to the Law on Personal Income Tax the three existing tax rates of the income tax, from 15% for income up to 360 000 MKD, 18% of income from 360 00 to 720 000 MKD 54 000 +18% of the share of income from 360 000 to 720 000 MKD, and for income above 720 000-118 800 +24% of the portion of income over 720 000 MKD, were replaced with a single rate of 12% in 2007 with its reduction at 10% in 2008. The rate of profit tax of 15% was replaced with 12% in 2007, decreased to 10% in 2008.

Along with the general tax rate reductions, came more incentives in favour of the free economic zones, i.e. so-called technological -industrial zones. Companies that invest in these zones will be completely exempt from paying profit tax for the first ten years, and with regard to income tax, the user of the zone is exempt of paying PIT for salaries of the employees in period of 10 years, from the start of performing of the activity in the zone, i.e. from the first month in which the user will perform the payments of salaries, regardless of the number of employees. Such tax policy was welcomed by the IMF and a number of independent experts, but not by the EU because the move means forgoing tax legislation in Macedonia from the EU law- *acquis*.

Desperate for foreign direct investment inflows, burdened with high unemployment and willing to provide impetus for vigorous restructuring, the Government of Macedonia decided to design competitive tax system. Positive experiences from other countries (Estonia, Lithuania, Latvia, Russia, and Slovak Republic) that have already introduced the flat tax system gave strong justifications for the tax reforms.

The Macedonian government that introduced the Flat tax (that is re-elected for the fourth time continuously) intended to illustrate and demonstrate that tax players (the state budget and financial institutions appetite) will be satisfied and tax payers will be complacent with reduced tax rates. Flat tax has insured this.

Additional strength that inspired Macedonian authorities to engage in adventure of reduction of the tax rates was, also, the requirement for decreasing the tax evasion and grey economy, that were almost a key trade mark of Macedonia, not only Macedonian but in all other ex federation' states. At this moment, Macedonia has new trade mark that can be called EPS, meaning *Everybody Pays Taxes*. Surely, the flattening of tax rates of income taxes, the lowest tax rate in Europe of 10%, made it accurate. Macedonia, also, endorsed the rule: "High taxes, low growth and *vice versa*, low taxes, higher economic growth". With the introduction of the flat tax model Macedonia became a leader in Europe amongst countries with lowest taxes, along with Kyrgyzstan and Kazakhstan¹.

The flat tax system adopted in Macedonia is the so-called proportional model with single tax rate and many non-standard deductions. The tax base is the individual income or the legal entity profits. The main feature of the system is a single tax rate for personal income tax and for profit tax amounting to 10% (Article 12 of the Law on Personal Income Tax and Article 28 of the Law on Profit Tax). Namely, earned income, business income and capital gains are taxed at a flat rate of 10% regardless of the amount of income that is earned or profits generated.

¹ Pendovska, V. and Dzafce, S., Flat Tax: The Case of Republic of Macedonia. *Pravni zivot*, 12/2009, 2009, 123-135.

2.3 Value Added Tax (VAT).

Generally, VAT (*Law on Value Added Tax*, Off. Gaz. RM no. 44/99 as amended no. 59/99, 86/99, 11/00, 8/01, 21/03, 19/04, 33/06, 45/06, 101/06, 114/07, 103/08, 114/09, 133/0995/2010, 102/2010, 24/2011, 135/2011, 155/12 and 12/14) is due on the supply of goods and services in the country sold/carried out from the taxpayer in the course of his economic activities. “Supply” refers to goods or services provided in exchange for consideration. However, certain transactions carried out for no consideration are also considered to be supplies, for example, private use of business assets.

The following transactions are generally subject to Macedonian VAT:

- supplies of goods or services whose place of supply is in Macedonia; and
- import of goods into Macedonia.

VAT can be charged only by VAT registered persons. An obligation to register for the purpose of the Value Added Tax has the taxpayers that:

- in the previous calendar year made a total turnover higher than MKD2.000.000;
- during the calendar year makes a total turnover over MKD2.000.000;
- start to perform an economic activity, if they anticipate they will make a turnover over MKD2.000.000.

The taxpayer can register for VAT purposes on voluntary bases if:

- in the previous calendar year made a turnover less than MKD2.000.000 on an annual level;
- start to perform an economic activity, but due to the amount of the assumed turnover are not obliged to VAT registration, which means they anticipate future turnover less than MKD2.000.000.

Taxpayer of the Value Added Tax (VAT) is a person who permanently or periodically performs an economic activity, regard-less of the goals and outcomes of that activity. Taxpayers of VAT can be legal entities and physical persons, as well as association of entities that realize income within the framework of their economic activity. Taxpayer of VAT can also be legally independent entities who are closely associated in ownership, organization and management - associated VAT entities.

VAT is calculated according to proportional tax rates, as follows: general tax rate of 18% and preferential tax rate of 5%.

2.4 Property taxes.

Along with the process of decentralization in the Republic of Macedonia, from 01.07.2005, property taxes (Property Tax, Tax on inheritance and gift, Tax on real estate turnover) are local taxes i.e. their administration is performed by the municipalities, as units of the local self-government and the City of Skopje, as a separate unit of the local self-government (*Law on Property Taxes*, Off. Gaz. RM no. 61/2004 as amended no. 92/2007, 102/2008, 35/11, 53/11, 84/12 and 188/2013).

2.4.1 Property tax.

Owners of immovable property situated in Macedonia are liable to property tax.

The tax is levied on the market value of the property on an annual basis, at a rate which ranges from 0.10% to 0.20%. This rate is determined by the municipality where the property is situated.

The person liable for the property tax is the owner (legal entity or an individual) of the immovable property, or the user of the property if a limited right to use the property was granted. The person using the property is liable for the property tax on immovable property owned by the Macedonian State.

2.4.2 Tax on inheritance and gift.

Certain individuals` inheriting property (movable and immovable) is subject to inheritance tax. A liability to Macedonian inheritance, estate and gift tax depends not only on the Macedonian tax residence position of the deceased/donor and of the beneficiary, but also on the Macedonian location of real estate and assets when the deceased/donor is not resident in Republic of Macedonia.

Inheritance and gift tax is paid for immovable property and for the right to usufruct and the usage of immovable property which the inheritors, i.e. the receivers of gifts inherit, i.e. receive on the basis of the law on inheritance, i.e. the gift agreement. Inheritance and gift tax shall be paid for cash, monetary claims, securities and other movable property if the market value of the inheritance, i.e. the gift agreement is higher than the amount of an annual average salary in the Republic of Macedonia for the previous year, according to the data from the state statistics office. The value of all gifts of the same type, received during one calendar year shall be considered one tax base.

Taxpayer of inheritance and gift tax shall be a natural person and legal entity – resident in the Republic of Macedonia that inherits property, as well as a natural person and legal entity that receive property as a gift, in the country and abroad. A taxpayer of inheritance and gift tax shall be a foreign natural person and legal entity – non- resident, for the immovable and the movable property it inherits, i.e. receives as a gift in the Republic of Macedonia.

Base for the inheritance and gift tax shall be the market value of the inherited, i.e. the property received as a gift, at the moment the tax obligation arises, reduced by the debts and the costs that are borne by the property which is the subject of taxation.

The tax rates depend on the relationship of the beneficiary to the testator or donor. Beneficiaries who are first degree relatives are not taxable. A gift tax is levied on donated property, as well as on property transferred without consideration. No gift tax is levied on property donated to spouses and immediate family members. The rate depends on the order of succession.

The inheritance and gift tax rates are in the following range:

- 2% to 3% for property inherited by/donated to brothers, sisters and their children;

- 4% to 5% for inheritance/gifts (donations) between unrelated persons.

The tax rate is determined by the municipality where the property is located.

2.4.3 Tax on real estate turnover.

The tax for the transfer of immovable property ranges from 2% to 4% and is levied on the market value of the property.

The tax rate is determined by the respective municipality where the immovable property is located.

Transfer tax is due by the seller of the property unless otherwise agreed between the parties.

Certain transfers of immovable properties are exempt from taxation including the transfer of an immovable property where contributed in kind for equity of a company, and the first sale of a residential apartment provided that the supply was subject to VAT.

3. *Tendencies: Facts and Figures*

Macedonian tax reforms in recent years have been driven by the commitment gradually to harmonize with the EU and by the desire to improve further the environment for doing business. Thus, recent tax reforms can be seen as a continuation of efforts to improve efficiency in the allocation of real capital, to enhance productivity and promote innovation and investment, to strengthen the competitive position of firms and encourage foreign direct investments. Furthermore, the efforts to implement a modern tax administration were fairly successful. The Macedonian PRO has been engaged in permanent improvement of its administrative capacity; implementation of modern technologies, elevating the qualitative standards in the procedures, thus coming closer to the standards and practices of the EU member-countries.

3.1 Latest trends: Results and Setbacks

In the last few years in Republic of Macedonia have been undertaken the following tax reforms:

- Personal Income Tax - Law on Personal Income Tax was amended, postponing the application of taxation on capital gains from the sale of securities until 2016 and delaying the application of taxation of interest on deposits until accession.

- Corporate Tax:

- * introduction of zero tax rate on reinvested profits

* simplified tax regime for small and micro businesses- Trade Companies classified as small and micro traders and legal entities residents of Republic of Macedonia, leading accounting and preparing annual accounts in accordance with the Law on Trade Companies (not performing bank, financial, insurance, and activities from the area of games of chance and prize games) which will realize total income at all bases up to 3 million MKD per year, are exempted from payment of annual tax on total income.

Trade Companies classified as small and micro traders and legal entities residents of Republic of Macedonia, leading accounting and preparing annual accounts in accordance with the Law on Trade Companies (not performing bank, financial, insurance, and activities from the area of games of chance and prize games), whose total income is from 3.000.001 to 6.000.000 MKD per year, are entitled to choose to pay either annual tax on total income of 1% or Corporate Income Tax of 10%.

- * tax incentives for investing in Technological- Industrial Development Zones (TIDZs)

- The user of the zone is exempt of paying Personal Income Tax for salaries of the employees in period of 10 years, from the start of performing of the activity in the zone, i.e. from the first month in which the user will perform the payments of salaries, regardless of the number of employees.

The user of the zone is exempt of paying Corporate Income Tax in a period of 10 years, if in a period of 2 years after the year of receiving the Decision for start of performing, under the conditions determined by the Law, starts with performing of the activity in the area.

*** Withholding Tax – The users of TIDZ which are performing payments of incomes to foreign legal person in Republic of Macedonia or abroad, are obliged in the same time of the payment of the income to withhold and pay the tax in amount of 10%, unless if it is otherwise regulated by the International agreements for avoiding of double taxation.

- The user of the zone is exempt from VAT on trade of goods and services in TIDZ (except trade intended for final consumption) and for import of goods in TIDZ (under condition the goods are not intended for final consumption).

- * effort to improve the fiscal discipline of the legal entities by implementation of Law on fiscal discipline (Off. Gazette of RM, no. 82/13 as amended no. 43/14).

- Value Added Tax

- * No tax rates changes (general tax rate of 18% and preferential tax rate of 5%)

- * In 2010 increase of total turnover for obligatory registration for VAT from MKD 1.300.000 up to MKD 2.000.000.

- * In 2011 and 2012 the most important VAT amendments are related to the preferential VAT rate. Thus, as an anti-crisis measure, the first sale of residential buildings/ apartments that are sold within the first 5 years of completion of the construction will be taxable with the 5% tax rate until the end of 2015; three more categories of goods/services will be subject to the 5% preferential VAT rate (raw oil for food production, commercial facilities` services – hotels, motels etc.-, for the import of personal computers, PC components, software and thermal solar systems), exemption from VAT on imports, shipments with a value of up to EUR 22 and on tickets for public events.

- * Starting from 2013 mandatory use of e-tax for the VAT taxpayers.

* In November 2013 new Draft-Version of the Law on VAT prepared with the GIZ technical support ensuring that the supply of goods and services would be taxed in one place, will establish an information system to change the information, will apply an electronic filing of tax returns, and one of the novelties in the law will be the commitment to exempt from VAT the sale of real estates. Part of the new VAT legal provisions will apply automatically, immediately after RM will join EU.

- Excise- the Law on Excise Tax was amended: it increases the excise duty on alcoholic beverages, while the increase for cigarettes and tobacco will be gradually applied over ten years.

Today, after summarizing the results of such policy there is compelling evidence that it revolutionized the tax system and provided economic stimulus for the far-from-vibrant private sector in Macedonia².

- The greatest benefit from the flat rate system is the introduction of tax simplicity, replacing the complexity of tax calculations that taxpayers have to go through.

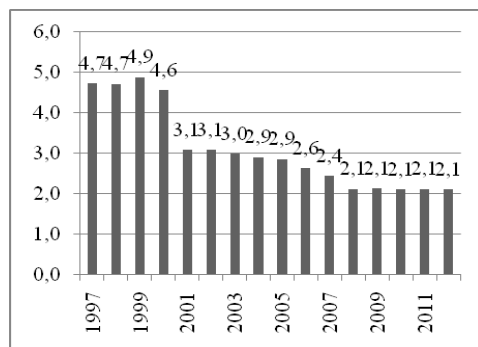
- It also fosters the administering and audits performed by the Tax Administrations decreasing the compliance costs. Cutting the tax rates and broadening the tax base hinders the incentives for tax evasion. In return, the fiscal discipline of taxpayers increases as seen by the improved collection of taxes that makes the flat tax system more efficient.

- As a consequence, tax revenues grow which was exactly the case with the Macedonian corporate income tax where the rate of revenue growth was over 60% comparing to the planned one in the first half of 2008.

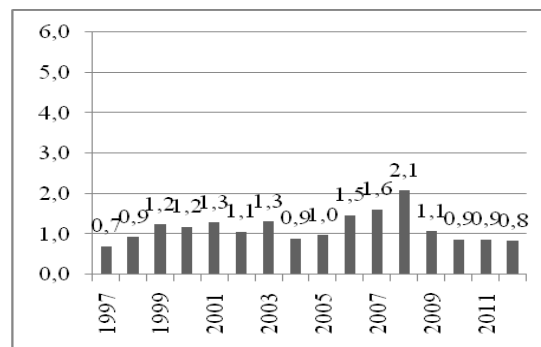
- Despite the replacement of three progressive tax rates with uniform, and reduced rate, the personal income tax also demonstrated satisfactory performance in terms of revenue mobilization.

² Maksimovska-Veljanovski, A., Stojkov, A. and Neshovska, E., Flat Tax in Theory and Practice. *Collection of Articles of the Law faculty of Skopje and Zagreb*, 2013, 207-212.

*Graph 1: Personal income tax revenue
1997-2012 (as a percent of GDP)*



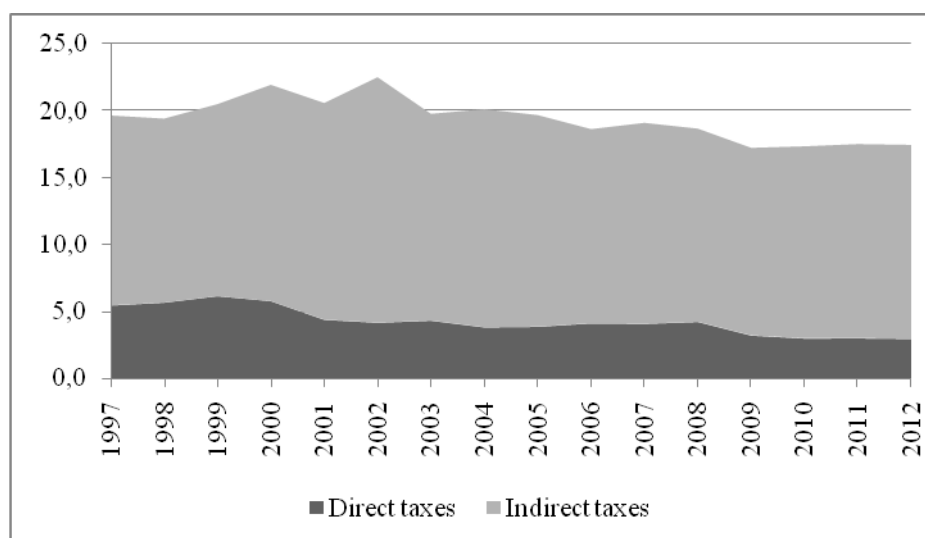
*Graph 2: Corporate tax revenue
1997-2012 (as a percent of GDP)*



Source: Authors calculation based on dates from Ministry of finance and Public Revenue office of Republic of Macedonia

Tax structure in Macedonian total budget is very diverse. In Graph 3 it is notable that in the last 15 years income taxes participate less in total budget revenues which means release of income taxation and move toward higher consumption taxation.

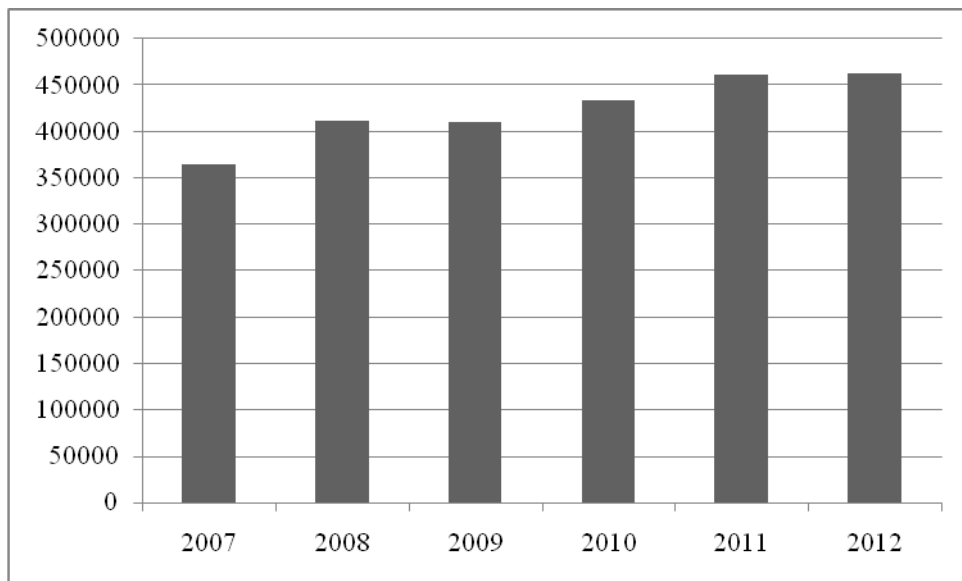
Graph 3: Tax structure in Macedonia (in percent of total taxes 1997-2012)



Source: Ministry of finance of Republic of Macedonia

There is increase of GDP not only in absolute but also in relative amount. Republic of Macedonia was not surrounded of the world financial crises but still has a higher GDP despite low tax rates.

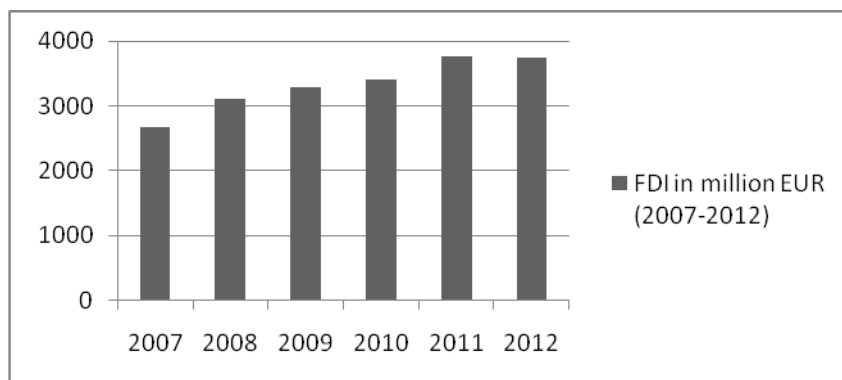
Graph 4: Macedonian GDP (2007-2011) in million denars



Source: State Statistical Office of Republic of Macedonia

The forecasted effects from the theory (as a direct benefit in the first few years of the flat tax introduction) undoubtedly occurred in Republic of Macedonia. It is evident the FDI increased in the period 2007-2008 (the first two years of the introduction of flat tax), but in 2009-2010 came to a relative decline of FDI, primary affected by the financial and economic crisis. However, FDI are now higher than in 2007 indicating justification of the introduction of the flat tax as a device to attract FDI.

Graph 5: FDI in million EUR



Source: State Statistical Office of Republic of Macedonia

3.2 Macedonian taxation in the European Commission Country reports

On October 16th 2013 European Council adopted the 2013 European Commission report (SWD (2013) 413 final) which for the fifth successive time recommends that the Council opens negotiations on

membership with the Republic of Macedonia³. In all MK Progress Reports, Chapter 16: Taxation, European Commission has given the following recommendations:

- As regards **indirect taxation**, some of the reduced VAT rates (5%) are not in line with the acquis. Some rates for excise remain lower than the minimum required by the acquis.

- In the area of **direct taxation**, the alignment with the relevant Directives (the Parent-Subsidiary Directive, the Merger Directive and the Interest and Royalties Directive) has yet to be addressed. The Law on special zones for technological and industrial development needs to be aligned with the EU Code of Conduct for Business Taxation.

- As regards **administrative cooperation and mutual assistance**, electronic data exchange between the public revenue office and the financial police intensified. A double taxation agreement with Luxembourg was ratified, bringing the number of agreements concluded with EU Member States to 24. These agreements do not cover debt recovery or the automatic exchange of information.

- In the field of **operational capacity and computerization**, voluntary compliance and enforced collection improved and electronic services were extended. Mandatory registration of cash payments was further extended. Electronic submission of VAT and profit tax returns was made compulsory. While the processing of VAT refunds improved, substantial efforts are required to reduce delays and build up a good track record of compliance with legal deadlines. A forensic laboratory has been set up to fight high-risk tax fraud, but is not yet operational. The action plan for reducing the informal economy was updated. However, the fight against tax evasion and the informal economy remains a challenge. Operational capacity and IT infrastructure, in particular, need to be improved.

The main conclusion is that there was some progress during the reporting period. Further efforts are required to align the direct and indirect tax legislation with the acquis and to achieve and maintain a good track record for processing VAT refunds within legal deadlines. The fight against tax fraud and tax evasion and efforts to combat the grey economy need to be further intensified. On the whole, preparations in the area of taxation are moderately advanced.

4. Conclusion

Tax reforms in Republic of Macedonia started in 1993 and were connected with political, economic and cultural changes in the early years of the state independence and at the beginning of transition period. The main objectives of the first major tax reform of 1993 were to create a modern tax system, consistent with an open market economy, to be efficient; internationally comparable and competitive; simple for application and "difficult" for evasion; and flexible. The next crucial reforms took place in 2000 when

³ European Commission, *The Former Yugoslav Republic of Macedonia 2013 Progress Report*, Commission Staff Working Paper. Brussels: European Commission, 2013, 53-61.

VAT was introduced, replacing the previous Turnover Tax, and in 2006 with the introduction of the flat tax (refers to personal income and corporate profits being taxed at one marginal rate - 12% in 2007 and 10% in 2008 onwards). The main taxes, now, applicable in the Republic of Macedonia are: personal income tax, profit tax, property taxes, VAT and excises.

Today, 7 years later, after summarizing the first results of flat tax policy there is compelling evidence that it revolutionized the tax system and provided economic stimulus for the far-from-vibrant private sector in Macedonia.

- The greatest benefit from the flat rate system is the introduction of tax simplicity, replacing the complexity of tax calculations that taxpayers have to go through.
- It also fosters the administering and audits performed by the Tax Administrations decreasing the compliance costs. Cutting the tax rates and broadening the tax base hinders the incentives for tax evasion. In return, the fiscal discipline of taxpayers increases as seen by the improved collection of taxes that makes the flat tax system more efficient.
- As a consequence, tax revenues grow which was exactly the case with the Macedonian corporate income tax where the rate of revenue growth was over 60% comparing to the planned one in the first half of 2008.
- Despite the replacement of three progressive tax rates with uniform, and reduced rate, the personal income tax also demonstrated satisfactory performance in terms of revenue mobilization.
- Furthermore, the financial crisis that caused increasing of tax rates exceed in Republic of Macedonia without introduction of higher tax rates. In other words, the flat tax in Republic of Macedonia has withstood the “winds” of the financial crisis without the need of leaning toward tax rates increase. Republic of Macedonia is a model in the region that encouraged some countries (Bulgaria, Serbia and Hungary) to introduced flat tax systems.

Macedonian tax reforms in recent years have been driven by the commitment gradually to harmonize with the EU law and by the desire to improve further the environment for doing business. Thus, recent tax reforms can be seen as a continuation of efforts to improve efficiency in the allocation of real capital, to enhance productivity and promote innovation and investment, to strengthen the competitive position of firms and encourage foreign direct investments. Additionally, the efforts to implement a modern tax administration were fairly successful. The Macedonian Public Revenue Office, also, has been engaged in permanent improvement of its administrative capacity; implementation of modern technologies, elevating the qualitative standards in the procedures, thus coming closer to the standards and practices of the EU member-countries.

The 2013 European Commission report (which, for the fifth successive time, recommends that the Council opens negotiations on membership with the Republic of Macedonia) suggests that further harmonization efforts have to be done under the European Commission's eyes wide open, particularly in the field of VAT and excises rates and exemptions.

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Tax Reforms in Republic of Macedonia: 2006-2014

(summary)

Tax reforms in Republic of Macedonia started in 1993 and were connected with political, economic and cultural changes in the early years of the state independence and at the beginning of transition period. The next crucial reforms took place in 2000 and in 2006 and they have been driven by the commitment gradually to harmonize with the EU law and by the desire to improve further the economic environment. The main objective of the paper is to provide an overall review of the major Macedonian tax reforms undertaken in the last few years and the crucial reforms' benefits. Principal conclusions are that the determination of the government for euro-atlantics integrations and efficient and competitive tax environment encouraged successful tax reforms in Republic of Macedonia as a gradual process of adaptation, although a lot has to be done in future.

Key words: tax system, flat tax, simplicity, efficiency, tax administration, tax modernization.