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***Fiscal Treatment of Culture and Arts in the Republic of Macedonia
with Emphasis on Direct Taxation***

1.Introductory remarks. Ever since the Egyptian pyramids and the ancient Hellenic theatre, Leonardo De Vinci and Michelangelo Buonaroti, until the Vienna opera and the Bolshoi theatre, art and culture have been financed by various instruments of government subsidies/aid, and/or by private endowments of donors. Art and culture *products* carry specific characteristics which demand government intervention in the process of providing necessary financial resources. Namely, we bear in mind the so called “law of non-efficiency of cultural production” ,as from the aspect of the technological and scientific growth, both culture and art seem to be positioned in a subordinated role in the global economy. Culture cannot be modernized in a sense that various industries can by utilizing the benefits of mass production (economy of scale). The artist and his creation stand in a most unique relation, relation which cannot be multiplied.

Furthermore, continuous technological progress in modern societies, places cultural activities in a relatively more difficult socio-economic position. Technologically efficient production may increase the profits as a result of increased global productivity. Artists, creators of works of art are frequently affiliated to institutions that are in no position to achieve economic growth and development in strict economic sense of the word, thus lagging behind, whilst other segments of society move forward.

Upon the abovementioned premises, we argue that art and culture cannot maintain autonomous and sustainable growth and development based upon the principles of profitability, self-financing and efficiency, contemplated *strictu sensu*. Therefore, the cultural stage is strengthened by two additional pillars: government and/or private donors. Comparative practices suggest the possibility of various combinations of these two additional sources of finance: in some countries the accent being on government financing, while in others private philanthropy prevails.

Every particular choice comes as a result of different traditions and heritage in the general social contexts, unequal economic development, different role of culture and artistic production in various countries, as well as the specific government “cultural policies” within the framework of the strategic objectives and consequently, the particular legislative *milieu* in every country.

The objective of this paper is to discuss the treatment of culture and arts in the tax law and tax policy of Republic of Macedonia, with emphasis on direct taxation (personal income taxation and profit taxation). The main issue is whether, and if so, to what extent are the governing laws on profit tax and on personal income tax *de lege lata* simulative in terms of financing culture and art. Secondly, what may be the optimal future directions aimed at improving the legislative framework *de lege ferenda*.

2. Brief historical recourse. The legal framework of direct taxation in RM is comprised by two major laws: Law on Profit Tax¹ and Law on Personal Income Tax².

The initial reading of the Law on Profit Tax did not proscribe any incentives for cultural activities, but it was included in the amendments of the Law enacted in 1995. According to these amendments (Official Gazette of RM 80/93; 33/95; 43/95 and 71/96) taxpayers were granted tax credit to the amount of funds invested in theater and film production, publishing, libraries, music performances providing that such activities are of national significance. Also, international cooperation in the field of cultural activities as well as the artistic objects and works of special cultural and historical importance were qualified for the said tax incentive. The following amendments to the Law (1996) regulated that total expenditure in form of donations and sponsorships for cultural, scientific and medical purposes, as well as in international sport may additionally be deducted as allowed expense in the annual tax account. This tax incentive was limited to 10% of reported profits before taxation, providing that certain criteria set forth by authorized Ministries have been satisfied by the taxpayers in question. The taxpayers interested to take advantage of the tax incentive had to present a formal document stating that the donated moneys are in accordance with the criterion “national interest”. In 2001 the legislator intervened in this segment by reducing the percentage of deductible donations from 10% to modest 3% of reported gross annual income of the company that donated funds for cultural, scientific, medical, religious purposes and for sport, with one exception, i.e. professional sport. Additional condition was that the donated funds had to be given to public institutions financed by the state budget, or in favor of the organization of the Red Cross in Macedonia.

Unlike the Law on Profit Tax which had incorporated regulations for stimulating donations in cultural organizations ever since 1995., the Law on Personal Income Tax has failed to address this issue up until 2006., when the entire situation changed dramatically.

3. Contemporary analysis. The situation was significantly improved when special Law on Donations and Sponsorships was adopted in 2006. The law represents *lex generalis* in relation to the Law on Personal Income Tax, with regard to tax incentives for giving funds for cultural purposes.

¹ *Law on Profit Tax*, Official Gazette of the Republic of Macedonia, no. 80/93, 33/95, 43/95, 71/96, 28/98, 11/01, 02/02, 44/02, 51/03, 120/05, 139/06, 160/07, 159/08, 85/10

² *Law on Personal Income Tax*, Official Gazette of the Republic of Macedonia, no. 80/93, 70/94, 71/96, 28/97, 8/01, 50/01, 02/02, 44/02, 96/04, 120/05, 52/06, 139/06, 160/07, 159/08, 20/09, 139/09

Donations and sponsorships are important, if not crucial financial source for the fulfillment of various objectives of wide public interest in modern societies, objectives that neither governments nor the business sector is able to fully achieve, through the mechanism of non-government organizations which have been granted Public Benefit Organizations status. Such areas of interest vary from education, sport, culture, environmental protection, social security and public health etc. Given that tax incentives have been long recognized as a powerful motivation for prospective donors, adequate legislation in this regard is of prime importance towards achieving the goal of strong and sustainable civic sector.

The Law on Donations and Sponsorships in Public Activities³ (LDSPA) was passed in April of 2006 and came into force as of the beginning of 2007, with subsequent amendments enacted in 2008. Drafting of this Law lasted for almost a decade, and for the first time in the history of the civic sector in RM, enabled individuals to enjoy tax benefits for donations in public benefit organizations (PBO's).

The adoption of the Law contributed towards establishing sound and adequate legal framework for direct tax benefits in favor of private donors and sponsors. The objective of the LDSPA was to enhance interest by individuals and companies alike for financing activities of public interest through concrete tax incentives. The expected outcome was more dynamic utilization of private financial resources for donations and sponsorships.

This is the first law in RM that regulates and channels giving for charity and PBO's. LDSPA corrected a serious flaw from the past by providing tax benefits for individuals, that are to be spelled out in detail in the Law on Personal Income Tax. The rationale being the well-known fact that individual donors are amongst the biggest philanthropists side by side with corporations. LDSPA regulates a number of issues, such as: the terms and conditions regarding giving and receiving donations and sponsorships in organizations of public interest; the persons who may qualify as donors and as beneficiaries; what items or goods may be object of giving; the allowed objectives and purposes of donations, and the procedure of mandatory monitoring, supervision and accounting applicable PBO's.

The Law proscribes tax benefits in the regime of all taxes applicable in RM: profit tax, value-added tax, personal income tax and taxes on property. The tax benefit is limited to a certain amount and/or percentage, and is in favor of donors providing that certain legal terms and conditions have been met. Further, the benefactor of a tax incentive in some cases may be the donor or the receiver of the donation or sponsorship, depending of the concrete tax in question. In this section we discuss the tax incentives proscribed only in the regime of direct taxation, spelled out in the Profit Tax Law and the Law on Personal Income Tax.

The tax incentives in the Law on Profit Tax refer to legal persons as taxpayers. The Law proscribes two forms of incentives: one for donations and the other for sponsorships, allowing possibility for the taxpayer to take advantage of one or both of these incentives. Namely,

³ Official Gazette of the Republic of Macedonia, no. 47/06

the donor company may deduct from its tax base calculated in the Tax Account the amount not exceeding 5% from the gross annual income for given donations in the current year, and for sponsorships the deductible amount is 3%⁴. These non-standardized deductions are to be presented in the Tax Account (Profit and Loss Account) for the purpose of taxation of non-deductible expenses, along with the Financial Statements for the previous year. To utilize this tax benefit, the taxpayer must present the following documents: contract for the donation, certified document confirming the public interest issued by competent government authority etc. The amount of given donations and sponsorships exceeding the allowed deduction, is added back to the tax base for the purposes of profit tax.

LDSPA also regulates the tax benefits in the regime of personal income taxation. Namely, when a physical person donates financial funds to legal persons, the donor is entitled to tax credit in the amount limited to 20% of the tax due, calculated in the Annual Tax Return, but not more than 24.000 MK den⁵. To utilize the tax benefit the individual donor must present a valid contract for the donation entered between the donor and the beneficiary person and a document confirming the actual payment of the moneys, along with his annual tax return. The beneficiary, PBO or physical person when acting as ultimate beneficiary (who receives the donation through a PBO), are not liable for personal income tax. The tax benefits stipulated in the LDSPA are in favor of individual donors and are created to strengthen domestic support for PBO's, as well as to enhance the ties within various interest groups and with society in general. In this manner, citizens are stimulated to express solidarity and social responsibility by giving to those in need.

When one looks at the actual situation on the field, one must conclude that the number of individual donors in Macedonia is rather small. The business sector in RM remains by and large the most significant donor, especially, the public enterprises, big companies and banks, etc.

According to the legislation, the Public Revenue Office is authorized for conducting supervision and inspection of given and received donations and sponsorships, in relation to the proper use of donations and sponsorships in all cases involving some kind of tax benefit.

The adoption of the LDSPA enabled the Republic of Macedonia to join the group of countries that actively stimulate donations and the development of philanthropic behavior, through creating legal framework for tax incentives for donors and various tax benefits in favor of receiving benefactors.

⁴ *Law on Donations and Sponsorships in Public Activities*, Official Gazette of the Republic of Macedonia, no. 47/06, Article 14, Paragraph 1 and 2, and *Law on Amendments to the Law on Profit Tax*, Official Gazette of the Republic of Macedonia, no. 139/06, Article 9

⁵ *Law on Donations and Sponsorships in Public Activities*, Official Gazette of the Republic of Macedonia, no. 47/06, Article 13, Paragraph 1, and *Law on Amendments to the Law on Personal Income Tax*, Official Gazette of the Republic of Macedonia, no. 139/06, Article 32

However, notwithstanding such positive trends introduced by the LDSPA, during a relatively short period of its implementation few important legal flaws have been detected. Namely, LDSPA in practice does not function to the highest expectations, mostly due to some legal voids and inconsistencies of the reading. Thus, there are problems with definitions and terminology; the procedure for obtaining documents for public interest takes too long and even some arbitrary practices in this context have been detected; the brief text of the law does not cover all relevant issues thus creating gray areas for dilemmas and legal voids. This is particularly vivid when it comes to donors who have been giving in the past; weak motivation for giving by both individuals and companies which makes this law almost de-motivating; the complicated administrative procedures for utilizing the tax incentives costing time and money and is with highly uncertain outcome; obligations for disclosure on behalf of the involved parties, etc.

To eliminate the abovementioned flaws, a set of measures seem necessary, amongst which are: radical legal changes in the existing law, or preparing a new Law on Donations and Sponsorships which will eliminate all inconsistencies regarding the terminology and bringing it into concordance with the definitions spelled out in the Law on Associations and Foundations (Off. Gaz. of RM no.52/2010). Secondly, in the process of drafting the new law all interested parties/stakeholders must actively participate i.e. companies, individual donors, public institutions, associations of citizens operating in various fields of interest. Further, the rights and powers of public authorities must be spelled out in a very precise manner, thus becoming cost-effective and strengthening the legal stability and certainty for prospective donors and benefactors as well. Finally, simplifying the procedure for using tax incentives and establishing centralized register of donations and sponsorships, creating a possibility for on-line electronic application would create a more favorable environment for the future development in this sector.

By adopting the LDSPA Macedonia made a big step in positive direction compared to other countries in the region. Although the implementation of the Law so far has been at a very slow pace, it is realistic to expect that in near future the positive effects of this legislation will emerge much more intensely.

4. Conclusive remarks. It cannot be forgotten that the primary objective of taxation is collection of fiscal revenues. The stimulation of culture and art belongs to the field of non-fiscal goals of tax policy, and as such, it is of secondary importance in the eyes of the state. The segment of various tax deductions, tax credits and tax exemptions - known as tax incentives - is in function of stimulating orientation of tax policy. Despite the trend of narrowing down the circle of incentives, which was prominent during the tax reforms in the industrialized countries during the 80-ties, none of these countries had given up at least one type of tax incentive aimed at achieving a variety of goals: regional development, foreign investment, environmental preservation and other tax benefits. Contemporary financial theory created a new *sintagma* to denote the instruments of government intervention through various tax

breaks and exemptions that is *tax expenditure*. Actually, any legal privilege in favour of taxpayers is digression from the general concept of tax law resulting in reduction of fiscal revenue⁶. Contrary to direct budget grants, as direct public expenditure, in the case of tax expenditures the state voluntarily "deprives" itself from part of its potential tax revenue⁷. The advantages and disadvantages arising from the application of direct public expenditure (budget grants, subsidies) on one hand, and the application of tax expenditure on the other, suggests a careful analyses of the effects, which are at first glance may appear identical, in the selection of the particular model of active fiscal policies. For example, the direct public expenditure is less obvious; the cost of tax expenditure is more difficult to control; various tax benefits contribute to the complexity of the tax system; it is not easy to determine the difference between potential and actual tax revenue, and finally, "hidden" from the eyes of the public, its benefactors demonstrate great resistance the future attempts aimed at abolishing the already acquired tax benefits. On the other hand, tax expenditure is more flexible because in this case, the taxpayer independently determines which segment of his business will be supported by the state, contrary to direct public expenditure.

In the practice of modern market economies direct public expenditure is applied alongside with tax expenditure. It is significant to note that these instruments are selected and established upon carefully selected criteria. In other words, starting from the argument that tax policy should be more neutral, the tax incentives should not be exercised on an *ad hoc* basis, but only for few precisely defined purposes (cultural development, technological development, structural adjustment, regional development, increasing employment, etc.).

In the former regime of taxation of income of the so called organizations of associated labour prior to the dissolution of SFR Yugoslavia, but also within the regime established by the Law on Profit Tax⁸ in independent and sovereign Macedonia, there were a large number of heterogeneous tax deductions and exemptions. This led to excessive administration and contributed to the complexity and non-transparency of the tax system in general. Often, the costs of these complex calculations did not match up with the positive effects of the tax benefits. Consequently, we should bear in mind that the strongest investment impulse is situated outside the tax regime as an isolated parameter, but rather lies in the positive prospects for future economic growth.

The comparative review suggests that in this domain significant reductions have been undertaken on a number of tax exemptions as a step in a positive direction, because the modern trends in fiscal systems of developed countries are taken into consideration and, more importantly, the experiences of many developing countries and transition

⁶ More about tax deductions and exemptions in: "Tax expenditures", Report by the Fiscal Committee on Fiscal Affairs, OECD, Paris, 1984, page 16-18

⁷ See: Stanley S. Syrey; Paul R. McDaniel, "The Tax Expenditure Concept and the Legislative Process", in "The Economics of Taxation" The Brookings Institution, Washington D.C. 1980 page 124-125

⁸ See: *Law on Profit Tax*, Official Gazette of the Republic of Macedonia, 5/1993, Article 9,13,14,15.

economies as well. The reduction of tax benefits as specific aberrations from the general regime of taxation to a reasonable level is necessary, not only for the fact that they cause loss of fiscal revenue (which ultimately can be compensated by other sources), but also because of the numerous weaknesses in the process of implementation.

The general principle in the theory of taxation is that the effectiveness and efficiency of one tax is inversely correlated with the number of goals to be achieved. Tax incentives have burdened the tax instruments with a set of goals. They complicate the procedure for assessment and collection, involving people, time and energy to achieve maximum effects. If the incentives are modest, the social and economic benefits will be insignificant. And, if there are too many tax benefits, it is realistic to expect significant erosion of tax base.

Tax policy is a powerful tool, by which can be exercised a range of goals - even cultural development- but tax policy is not almighty. If in one state the culture and the creation are located at the high ranging of individual and social values, it is necessary integral or systematic approach where only one segment would be a stimulating tax policy. In other words, it is not enough to establish only few tax exemptions for the investment in cultural activities. Along with that, other possibilities should be explored, not only in the domain of financing, which, in its totality, would create a climate of high respect for the artist-author and his work, and would despise sub-culture that is, unfortunately, widely spread in these areas. The cult for beauty of artistic expression, aesthetic approach to life in general, civilized behaviour and communication, in my opinion, are virtues without which neither individuals nor societies can be characterised as civilized. In achieving these high goals, the role of family and educational institutions is of great importance. Finally, the role of government which through its legal instruments is able to create effective impulses for the stimulation of cultural expression and artistic creation.

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