TAX TREATMENT OF NPOs IN MACEDONIA

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1. Introduction

The freedoms of expression, association, and peaceful assembly are the hallmarks of a democratic, open society. Individuals should be empowered to pursue their common objectives and interests both individually and associated in organizations, should they feel that might be a more effective method of accomplishing the desired goals. Individuals may form groups that range from ad hoc neighborhood organizations created to solve problems of dirty streets to large assemblies of individuals joined together to protest natural and environmental pollution/degradation. Known variously as "non-profit", "non-governmental", or "civil society" organizations, this set of institutions includes within it a bewildering array of entities – hospitals, universities, social clubs, professional organizations, day care centers, hobby clubs, environmental groups, family counseling agencies, sports clubs, job training centers, human rights organizations, volunteers fire brigades, and many more. Non-the-less they all have common features that distinguish them from both market and the state.

NGOs are predominantly organized as institutions, separated from the state (private; non-governmental), they do not distribute profit to managers and "owners', they are self-governing (having control of their own affairs) and voluntary (membership is not legally required and they attract some level of voluntary contribution of time and money). Such organizations may be informal, without separate legal personality, or formal legal entities/persons, i.e. established and registered in compliance with governing laws of a particular country. Trends indicate that NGOs organized as legal persons play a crucial role in the process of creation of an open, diversified, democratic society. There are several reasons for that, which range from having a separate bank account and having perpetual existence separate of the existence of any member, to becoming eligible form tax and other benefits/incentives and receiving donations. These obvious advantages contribute to their structural, and most notably, to their financial potential/strength, which leads to increased influence in a society as a whole.

Democratic societies must have laws that protect the right of individuals to express their opinions and views freely, and to come together in a joint effort in pursuit of a common objective. The laws should permit, protect and regulate the civic organizations that chose to obtain legal personality, thus enshrining and securing the freedoms of expression, association and peaceful assembly for all citizens. At the same time there must be laws that are aimed at protecting the public from possible abuses by civic organizations.

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2. International standards for the legal and fiscal framework for NPOs

Modern times are characterized – amongst other trends – by an ever-growing interest in a wide array of social organizations that function outside the market and the state. This is true in Central and Eastern Europe, in NICs of the former Soviet block, throughout Asia, Africa, Latin America, as well as in the traditional welfare states of Western Europe and North America. The interest of the public corresponds to the unprecedented growth of such organizations, not vivid solely through increased number of entities[2], but through their increased importance in the *social milieux* over the past several decades.

The "associational revolution" (Salamon 1994) may have resulted from reduced capabilities of the state to cope on its own with the social welfare, development, environmental challenges etc. of our time, and from the fact that citizens have sought to take a more direct and active part in solving social problems and public affairs in general.

International customs and case law have paid close attention to these developments, and a number of documents – resolutions, declarations, conventions – have been adopted by international and regional organizations for the purpose of providing legal protection of the right to freedom of association, internationally. Of paramount importance in this context is the establishment of the European Court of Human Rights, a truly international court with special mandate to interpret the rules governing the freedom of association. During the course of its functioning the Court has set forth clear and strict standards that must be satisfied before any interference with the freedom of association can be justified.

The most important international law documents that are relevant for the civic sector are the UN Universal Declaration of Human Rights of 1948, the European Convention on the Protection of Human Rights and Fundamental Freedoms of 1953, and the International Covenant on Civil and Political Rights of 1976.

The Universal Declaration provides that everyone has the right to freedom of opinion and expression, and of peaceful assembly and association. Further, it states that no one may be compelled to belong to an association. Although not an international treaty but a resolution/declaration not aimed at binding states, it has come to have normative effect by influencing subsequent international treaties on human rights, and by influencing substantially domestic legislations in the field of human rights and freedoms.

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[2] For example, 1998, there were 1.6 million total nonprofit/tax-exempt organizations in the U.S.A. Of these 1.2 million were "independent sector" organizations – namely, charities, social welfare groups and religious organizations. The number of charities 501(c)(3) in 1998 has increased more than two and a half times the number twenty years ago. That same year 6.7% of national income was generated by the nonprofit sector, including the value of volunteer time. 70% of households contributed in 1998-giving an average gift of $ 1,075. Data source: *INDEPENDENT SECTOR's* Nonprofit Almanac, Published by Jossey-Bass, Washington, DC, 2001

The European Convention, ratified by over 40 member-countries of the Counsel of Europe in the region, provided the right of freedom of expression (Article 10), association, and peaceful assembly (Article 11). Complaint procedure has been regulated and the European Court of Human Rights established. Recent decisions of the court make it clear that there is a right protected under in't law to found a civic organization, and that once established, that organization is fully protected from any restrictive acts from the state that would impede the rights of individuals to freedom of association.[3]

The most important international human rights treaty providing the freedom of association and assembly in connection to the freedom of expression is the International Covenant on Civil and Political Rights, Article 22 (ICCPR) (1976). Over 140 countries ratified it. The ICCPR provides that: *everyone shall have the right of freedom of association with others including joining trade unions, and no restriction may be imposed on the exercise of this right other then those prescribed by law.*

These three cases are of major importance, since they provide strong and effective international law protection for the right to establish legally recognized NGOs, and once established, to operate with a minimum of state-imposed limitations and restrictions.

The freedom of association may be limited – according to both ECHR and ICCPR - only for the reasons of: (1) national security and public safety, (2) prevention of disorder or crime, (3) protection of health or morals, and (4) protection of rights of freedoms of others. These restrictions must be prescribed by domestic laws of any particular country wishing to impose limitations to the right of freedom of association.

It is obvious that international law has imposed very strict precedent-law rules on interfering or restricting the freedom of association.

The right of individuals to form associations has been recently confirmed by un important resolution of the General Assembly of the UN: Declaration on the Right and Responsibility of Individuals, Groups and Organs of Society to Promote and Protect Universally Recognized Human Rights and Fundamental Freedoms.[4]

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[3]In the well-known SIDIROPOULOS decision (1998) the ECHR unanimously held that the refusal by Greek courts to register a Macedonian cultural association was *an interference with the applicants' exercise of their right to freedom of association.*
Of similar importance is the decision (also 1998) holding that the action by Government of Turkey to dissolve the United Communist Party of Turkey was a *violation of Art.11 of the Convention.*
Third significant decision is Freedom and Democracy Party (OZDEP) v. Turkey, 1999, where the Court held that dissolving of a party before it begun any activities is too radical and presents interference with the right to freedom of association and links it directly to the right of expression, both protected by the European Convention. All court decisions may be found at: http:// www.incl.org/info/summs.html..

[4] G.A. res 53/144, U.N. Doc. A /RES/53/144 (1999)

3. NPOs within the Macedonian Legal Environment

The Constitution. Macedonian Constitution of 1991 guarantees the freedom of association of citizens for the realization and protection of their economic, social, cultural and other rights and convictions (Art.20). The constitutional guarantee of freedom of association reflects both the international covenants that Macedonian government committed itself to, by ratifying all major international treaties and acceding to conventions (specifically the Stability Pact and the Stabilization and Association Agreement with the European Union), but also the determination to strive for a democratic open society. Macedonian constitution has been the legal flagship of true liberal and free civil society.

The freedom of association of NGOs, under the Constitution and the Law on Associations of Citizens and Foundations of 1998 (LCAF), may be interfered with only under the following circumstances: if their program or activities call for "violent overthrow of legitimately elected government, if NPOs are pursuing military aggression, and stirring national, racial or religious hatred and intolerance. (Art.4 LCAF). Military and quays-military associations apart from the Macedonian national army are also forbidden. The Constitution Court of RM has mandate to rule final decisions on these issues. The decision of the Constitutional Court shall have the effect of legal ground for termination of those NGOs, who act contrary to the constitutional rules. It is evident that the rules enabling interference, *per se*, are an expression of ECHR *justified interference causes* of national security and public safety, preventing disorder, protection of freedoms and rights of others.

It is interesting that any citizen may initiate court action for the purpose of termination of an NGO if there is reasonable suspicion that its activities are contrary to the Constitution (so called *actio popularis*).

Historical recourse. The present Law on Associations of Citizens and Foundations (LCAF)[5] is not the first statute to regulate the civic sector in Macedonia. LCAF actually superseded the former Law on Social Organizations and Associations of Citizens dating back from Socialist Federative Republic of Yugoslavia (SFRY) era, which remained into force after the establishment of sovereign and independent Republic of Macedonia.[6]

However, the law was inadequate for the "newly-born free democracy" era, which led to the adoption of LCAF, a law that regulates the creation, membership, functioning, management, assets and property, and the termination of NPOs in Macedonia.

[5] See: Off.Gaz RM no 31/1998 as amended in 2007 (Off.Gaz RM no 29/07)

[6] That was only temporary, until a new law would be adopted by Macedonian parliament. The legal grounds for the extension of the Law was the fact that the Law did not contradict substantially the Macedonian constitution, according to the Constitutional Law of 1991 for implementation of the Constitution. The interim character of the former Law dragged on until 1998, the year it was superceded by the LCAF.

We now turn to the basic legal features of NGOs as regulated by the Law on Citizens' Associations and Foundations of 1998, amended in 2007.

Law on Associations of Citizens and Foundations (1998) The general provisions of the law provide that there shall be two main types of NGOs: citizens' association as association of persons, and foundations as association of property (pool of funds). They are legally defined as non-for-profit organizations, concept that is addressed in the same law. Non-for-profit is described in a way that, all surplus income must be used exclusively for financing the statutory purposes of the entity. CAs and Fs are not allowed to engage in any type of political activity, nor may they utilize assets for the benefit of political parties. Political activity is further described as direct involvement in election campaign, raising monies or financing a political party. (Article 3)

NPOs gain legal personality status by entering into the Central Registry of RM. Once duly registered, NPOs have perpetual legal existence, meaning there is no need for periodical renewal of their legal status. Legal personality status encompasses similar powers, rights and privileges, immunities and liabilities generally applicable to legal persons. However, NPOs cannot be transformed into any other type of legal entity.

NPOs can hold assets and own property. They are liable to third parties with the whole of their assets. NPOs are not allowed to perform economic activities directly, but they can set up separate commercial, subsidiary companies for pursuing such commercial purposes. All corporate income received by the parent NPO entity must be utilized for performing the legitimate public benefit activities of the NPO. (Article 7). Failure to comply with this requirement may result in loss of the not-for-profit status, followed by serious legal consequences to the future existence of the organization. In effect, it may lead to its involuntary termination.

NPOs must have Statutes and other Incorporation Documents, containing minimum elements prescribed by LCAF, such as: name and seat; statutory purposes and goals; organs and management; assets and property; membership of CA; representation; termination etc. Elements may vary for foundations, to reflect their *differencta specifica.* (Article 20)

The Law sets forth certain mandatory requirements that must be complied with. Worth mentioning is the minimum membership requirement for establishing a CA, which is set at five founding members. (Article 17) Foundations are required to have initial capitalization in-cash of no less than 10,000 DM (approx. 5.000 Euro) in denar-counter value on the day of registration. Similar requirement should be carefully sought throughout the law, should one be interested in actually establishing an NPO in RM, or engaging into an in-depth analysis of their legal status. However, a detailed and in-depth analysis of NPOs is not the subject of this paper. Rather, this brief overview is considered to serve as an introduction to our main topic – tax treatment of "civic society" organizations under the current tax law in RM.

Two issues not adequately treated in LCAF – in my view – have major impact on what we have "on the field' presently.

Firstly, there is no clear legal distinction between member benefit organization and public benefit organization. More precisely, the law makes an attempt to overcome the lack of genuine, internationally recognizable PBO concept, by introducing an original concept of *Citizens' Association with Public Authorization.* (Article 12) The core element is delegation of power to perform certain activities, by relevant government Ministry to the CA. The Ministry shall take into account the character and the domain of CA activities; the professional purposes and objectives; public need for the activities and the services rendered by the CA; institutional capacity and permanency of existence.

The public authorization may be revoked at any time, on grounds of misconduct or poor performance. The law does not elaborate further the concept of "Public Citizens' Associations". In this respect, secondary regulation appears to be necessary, or amendments to the Law.

Secondly, in the following, Article 13, one encounters the only brief provision dealing with fiscal treatment of NPOs in the whole statute. With respect to that provision, CAs and Fs may obtain tax and customs benefits, according to law. Mention is not made on the relation between the citizens' associations with public authorization and tax preferences being more generous, versus ordinary CA. That is all that may be sought in the LCAF, concerning the fiscal treatment of NPOs.

It is evident that *de lege lata* the regulation appears to be insufficient since it fails to provide adequate and detailed provisions regulating public benefit organization. Furthermore, this type of NPO – to the contrast of an ordinary NPO - ought be granted more favorable fiscal treatment, thus securing the long-term financial sustainability and growth of PBOs. The arguments in favor of such tax privileges are well-known and widely accepted as good international practice. In this occasion we mention only one: loss of tax revenue resulting from extended tax preferences is balanced, if not out-weighed/surpassed by numerous benefits from services and activities provided by the civic sector. Why? Because the modern state – given the funding and other limitations occurring over the past several decades – has reduced capabilities to successfully cope with such numerous and diverse needs, interests and goals, in short, activities that the citizens may find worth-wile.[7]

Macedonia has experienced a renaissances of its half a century *dormant civic society*, over the past two decades, with several thousand newly registered organizations, mostly CA and to a considerably minor extent other types of NPOs (primarily foundations). The importance of civic society in such a diverse society -as Macedonia is today- in terms of minorities and different social groups; variety of cultures, traditions, religions etc. need not be specifically stressed. It is a condition sine qua non at present, and even more for the future. This fact by itself must present a serious challenge

[7] For a more comprehensive discussion on the issue of the benefits of NPOs for society see: *Guidelines for Laws Affecting Civic Organizations, prepared by OSI* and INCL, 1997 p.11

for the legislator and the government as a whole, once the impact of the civic sector is recognized, to facilitate and assist its growth.

Taxation is a powerful tool in the hands of governments, to induce changes or sustain positions of the taxpayers under its jurisdiction. Taxes may have positive effects over a sector, or an industry; in other instances they may have negative effects (excessive taxation; double and multiple taxation; taxing the poor act.), or taxes may simply preserve the situation unchanged – so called *neutral taxation.*

The expectations for CEE governments and Macedonian government alike, is to establish favorable tax conditions for the growth of the "third sector", as an element of an overall conscious effort aimed at preserving and further developing an open, democratic society, united in its diversity.

4. Taxes and other fiscal levies applicable to NPOs in Macedonia

Once duly registered with a competent court register, NPOs gain the legal personality attribute. Thus, they automatically are subject to all fiscal instruments applicable to legal persons in general, with the exceptions regulated by applicable tax law. NPOs are liable for profit tax at entity level, personal income tax and social contributions for their staff (except for volunteers), property tax, gift and inheritance tax, VAT on purchases of goods and services, customs and other import duties, as prescribed by tax and customs laws and secondary regulations.

4.1 Profit tax and Personal Income Tax Preferences for NPOs

Under the present income tax laws NPOs are, essentially, not treated differently than business organizations or any other legal entities. There are modest tax incentives for an individual philanthropist, in a form of limited tax-credit for charitable giving. One of the reasons for such inadequate tax treatment of NPOs could be that the tax reform in the field of income/profits taxation was completed 5 years before the LCAF was enacted. Not having in place a clear legislative profile of NPOs in all relevant aspects, made it impossible for the legislator to prescribe fiscal incentives by tax law in a sufficiently detailed and consistent manner. Rather, tax laws followed the rationale of neutrality principle, meaning that the system provides as little deviations from the basic tax rule as possible, thus broadening the tax base and combining it with moderate and low tax rates. As a result of this attitude tax laws initially contained but a few provisions – tax incentives - applicable to NPOs.

There are two major legislative sources for determining the tax treatment of NGOs in Macedonia are: (1) Law on Profit Tax, and (2) Law on Personal Income Tax.

One should in addition be aware of the presence of the Law on Real Estate Taxes, which regulates the property tax on immovable and movable property, taxation of gifts and inheritance, and finally, the sales tax on disposing of immovable (real) property. Significant

role have the social security contributions, which are not taxes *strictu sensu*, but come very close to the former, primarily as a result of their compulsory nature, withholding collection method and relatively high rates.[8]

As it was already mentioned, NGOs are liable under the provisions of the **Law on Profit Tax** as any other legal person. Apart from the explicit statutory tax-exemption for entities employing disabled individuals that was abolished in 2001, the law provides one possible legal relief from taxation of NGO income deriving from membership fees.[9] Namely, tax-exempt is any type of income that is strictly designated for carrying on the activities of the legal person – the tax-payer (from budgets, funds, membership fees etc.).

Article 20 regulates the beneficial tax treatment of funds donated for public interest purposes from business entities to organizations that provide such activities and/or services. Initially, the reading was as follows, *(..) expenses incurred for the purpose of donations and grants for cultural, scientific, health-care and international sport, under the conditions set forth by authorized ministry, are treated as regular business expenses not to exceed 10% of reported pre-tax profits.*

The amendments to the Law of Dec. 2006 have altered the cited provision, thus narrowing down the tax incentive for investing funds in NGOs down to only 3% of gross income for sponsorships and 5% donations. This fact indicates changes of the political attitude towards the third sector and its financial sustainability, and it is neither favorable nor stimulative. To the contrary, the tax incentive for potential corporate donors has been minimized compared to the previous one.

The Law on Profit Tax does not recognize nor it regulates special "tax-exempt" status of non-profit public benefit organizations. The exemption that existed for several years and was reserved for companies that are organized to provide professional rehabilitation and companies that employ handicapped individuals to work under special conditions (both in manufacturing and in the area of services) by no means reflected the complexity and the diversity of activities performed by PBO's that serve public interest. Thus, at present, all legal persons, who registered and have their seat within the territory of RM *and realize profits* are liable for profit tax. Needless to say the scope of "legal personality" encompasses the commercial, business sector, government and public administration institutions, and the not for profit sector, thus creating an unprecedented practice of equal tax-treatment of two intrinsintly different segments of society. The implementation of the law neglected one decisive legal fact proscribed by the same law, in determining who is liable for profit tax, that is,

[8] The current rate of social security contribution is much higher than the rate of personal income rate, and is 20 + 7 + 1,5 = 28,5% and the respective tax rate is 10%.

[9] Art.17 (2) of the Law on amending the Law on Profit Tax, Off.Gaz. RM , no.11/01). The Law on Profit Tax was first published in Off. Gaz. RM no. 80/93, and has been amended a number of times. Last amendments are published in Off. Gaz. No 159/08

earning profits from operations in RM and abroad. It is hard to believe how could such an obvious fact have been overlooked by the competent authorities, and almost the entire not-for–profit sector was, contrary to law and internationally recognized principles and practice, subjected to profit-tax liability (e.g. State Faculty of Law in Skopje is liable for profit tax!).

The Law on Personal Income Tax (LPIT) regulates the tax liability of natural persons, or of individuals. The major principle of the law is global taxation of income from whatever source during one-year period /taxable period correspond to the calendar year/ originating from Macedonia or from abroad (world income principle), realized in-cash, in-kind and in any other way. Non-residents are liable only for income generated within the territory of Macedonia. 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 progressive tax rates are applied. Initially (1993) three rates existed ranging from 23% to 35% of so-called cascade progressive tariff.

In 2001 significant changes have occurred concerning the level of tax rates as well as the method for determining the schedules/brackets of the progressive tax tariff. Instead of three brackets with corresponding rates of 23%, 27% and 35%, as of Feb.2001 there were only two rates: 15% on monthly income not in excess of 30 000 MK denars and a higher rate of 18% levied on income increments over 30 000 MK denar plus 4500 MK denars. On annual basis, PIT was levied at the same two rates: the basic 15% rate on yearly taxable income not in excess of 360.000 MK denars, and for income higher then the statutory threshold, 54.000 MK denars and 18% of the portion in excess of 360.000 MK denars.

Apparently, tax rates have been lowered and progression narrowed down to two instead of the previous three brackets. When we compare the highest marginal rates, e.g. 18% and 35% it is obvious that the tax burden was almost halved, that could spur employment, since the employers pay PIT.

Five years later Macedonia undertook a complex tax reform featuring the so called flat-tax system concerning income and profit taxation. Consequently, progressive rates were abandoned altogether and a new single rate of 15 % was instituted (2006) to be further lowered in the coming years: 12% in 2007 and 10% in 2008.

In addition, computation of personal allowance is changed rather radically: instead of initial 1/4 of average annual wage at national level tax exempt income, and subsequet personal allowance of only 30 000 MKD on annual basis, today this item is set at the amount of 84.000 MKD (Off. Gaz. RM no 159/08).

For a very long time unfortunately, individual philanthropists were not entitled to any kind of tax incentive on the income that they donate for charitable and other not-for-profit purposes, to registered NPOs. The Law on Personal Income Tax regulates over twenty items that are exempt from income taxation, but not a mention is made of tax-exempt donations No deduction from income subject to tax was allowed for the portion of income donated to NGOs.

As of 2006 the legal situation has improved by allowing deductions from the tax base of individual donors to registered public

benefit organizations with one serious limitation: the amount that is deductable may not exceede 24.000 MKD per annum (Off. Gaz. No 139/06. A. 32).

4.2 Sources of Income Exempt of Tax. Income from donations, grants and membership fees

NGOs are liable under the provisions of the Law on Profit Tax as any other legal person in Macedonia. The law provides one possible relief from taxation of certain types of income for NGO's.

Namely, Art. 15 proscribes that:

"Income from receipts that are strictly designated for performance of the activities of the legal person – tax-payer (budgets, funds) are not included in his tax base for the purposes of profit tax"

The folowing paragraphs enumerates examples of such designated income: receipts from special accounts, donations for designated purposes, membership fees and other funds which are received for the sole purpose of collection and distribution. The tax payer who is a beneficiary of such funds is obliged to take a formal decision for operating with those funds, as well as financial plan and programe describing the terms and conditions for spending these strictly designated funds (Art. 15 Off.Gaz. no. 139/06).

These amandments clarify the previous provisions which could have been interpreted in various ways, thus resulting in uncertainty whether particular class of income may fall under the above definition. As a result is of the above described amandments it is now beyond any doubt that donations and membership fees constitute tax exempt classes of income.

Thus, the overall legal framework in RM only partially corresponds to international good practices, and moreover is burdened with a number of weaknesses (unstable, unclear, incomplete, imprecise, inconsistent) the result of which is unfavorable legal and fiscal climate for the growth of the civil society in Macedonia.

4.3 Income from economic activities

Income from economic activity must be reinvested in the NPO and used solely for its statutory and legitimate purposes, contained in the by-laws. Sporadic, from time to time economic activity related to the principle goal of the NPO may be conducted. The moment income is used for other purposes or distributed elsewhere, the NPO loses its not-for-profit character, fact that in effect may lead to dissolution of the entity.

Macedonian NPOs are not allowed to engage in economic activities directly, but only through a separately established commercial subsidiary company. The company has all attributes of a regular business entity governed by commercial law, and consequently is being taxed like all business organizations. This is a rather rigorous legal approach, given that the majority of CEEs allow

some tax benefits, at least for a portion of that income under terms and conditions prescribed by law.

While we are at the comparative issue, it is worth mentioning that profit tax rate in Macedonia is amongst the lowest in the region, and in the European Union member-countries as well, presently set at 10%, fact that may partially off-set the negative effects of taxing income derived from economic activities of NOPs.[10]

4.4 Passive investment income: dividends, interest, capital gains, and royalties

Business income does not include income from portfolio investments. Portfolio investments are considered to be passive investments. NPOs may earn income from investments directly, because they have unlimited access to purchasing, holding and trading with all financial products that are available at the capital market in Macedonia.[11] Dividends from their subsidiary company are taxed at that company level with profit tax and are then received by the recipient NPO. Of course, NPOs may invest in stocks of various companies and generate income which will not be included in the tax base, if it has been taxed once at company level and if that company is a resident of RM. Dividends from non-resident companies may not enjoy this incentive, and will be taxed twice (second time at recipient level) unless a Double-Taxation Treaty between the countries is in place. Macedonia has signed and ratified more than 40 tax treaties, where dividend income on non-residents is taxed in most cases at a 10 (15), in some cases at a lower rate of 10% and even 5 %. Interest and royalties are generally taxed by 10% withholding tax, or are tax exempt.

NGO's may receive interest from bank deposits and other debt instruments (government bonds, treasury notes etc.) that are taxable as ordinary business income, except interest from government bonds, which is tax exempt. The latest amendments of the Personal Income Tax Law provide for exemption from taxation of several types of interest: from government loans, a vista bank deposits, savings deposits, bonds issued by central government and municipalities. This benefit is in favor of individual resident taxpayers, and it is unclear whether the same treatment is extended to legal juridical persons (NGO's inclusive), since Profit Tax Law is not explicit on the same issue.

Capital gains from sale of securities and immovable property are included in tax base in the amount of 70% and taxed as ordinary income. Capital loss may be off set by capital gain and the remaining loss may be carried-forward up to three years.

Law on Real Estate Taxes regulates: (1) real estate tax (on immovable and on movable property); (2) inheritance and gift tax, and (3) tax on disposition of immovables and rights.

[10] See: Art. 26 of the above cited law in fn. 4.

[11] See: Law on Personal Income Tax (LPIT), Off. Gaz. RM no.80/93 as lastly amended in 2009. See: Off.Gaz. no.139/09

According to the Law, exempt from property tax on immovable are: *(.) buildings and land that are used for educational, cultural, scientific, social, health-care, humanitarian, sports purposes, except buildings and parts of buildings that are in economic exploitation or are rented; and, business buildings where so called "protective workshops" (companies that employ disabled, invalids etc.) are situated Art.8).*

Article 18 of LPT stipulates exemptions from inheritance and from gift taxes to the following entities:

- government organizations;
- municipalities and city of Skopje;
- Red Cross organizations;
- *humanitarian and social institutions, educational, cultural institutions and religious communities,*

on gifts and inheritance consisting of immovable and movable property, in cash and in receivables.

Real Estate Sales Tax. The tax on disposition of immovables and rights is levied in cases of transfer of property for a price, exchange of immovables and any other case of acquiring immovables and rights between natural and judicial persons, for remuneration. There is no exemption from this tax for NGO's.

4.5 Indirect Taxation and NPOs.
Value Added Taxes

VAT was made effective in Macedonia as of 1999, to supersede the long-lasting single-stage retail sales tax. VAT is structured according to the major principles and rules recommended by the Sixth EU Directive on VAT[12] It is applied on all transactions and imports of goods and services – except the ones that are VAT exempt- at a single rate of 18%. Additional lower rate of 5% is applicable on selected items. There is no 0% rate, which has negative effect on the organizations in the not-for-profit sector.[13] This means that NPOs are not in a position to seek VAT rebate for their purchases. VAT rebate is possible only for entities, which are registered VAT taxpayers. It is tricky whether this purchase of animal food should be done by a separate company or directly. In case of direct purchase by NPO that is not registered for VAT, there shall be no VAT rebate. This could be possible in case separate commercial company has been set up and is registered for VAT (has annual turnover in excess of 1.300.000 MKD).

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[12] See: *Law on VAT*, Off.Gazz no 44/99; *Decision on Good and Services Taxed at Lower VAT Tax Rate*, Off. Gaz no.65/99. Also see*: Sixth VAT Directive*, (77/388/EEC). A common value added tax system in now applied in all Member States. A transitional VAT system became effective on 1 January 1993. In July 1996 the European Commission presented its programme (COM (96) 328 final) for a gradual move toward definitive VAT system.

[13] Details on current tax rates in CEEC's see: *IBFD Publications BV Amsterdam 1999, Central & East European Tax Directory. See also: European Tax Handbook, by the same publisher, 2000.*

In specific and rare cases not-for-profit organizations may seek VAT rebate on purchased/imported goods, under conditions prescribed by the Law on VAT (Art. 47.) These conditions are the following;

- the transaction is not by law exempt from VAT;
- VAT was actually computed, documented, invoiced and paid;
- VAT on imported goods actually paid;
- goods in question ought to be transferred abroad and utilized for humanitarian, charitable and/or educational purposes.

The Minister of Finance shall pass regulations for more detailed regulation of the procedure of VAT rebate, in such cases.

Law on Customs

The Law on Customs of 2005 (Off. Gazz. RM no.39/05) has provided the following incentives for NGO's on imported goods:

- Red Cross of RM on goods that are related to its humanitarian operations;
- museums and art galleries for product directly connected with their activities;
- goods that are directly used for cultural activities, providing the importer is duly registered for non-profit cultural activities and the products are not manufactured in RM;
- imports directly utilized in social services and education;
- etc.

Furthermore, customs incentives in a form of exemptions are provided for goods imported by registered humanitarian and charitable organizations, for the purpose of distribution to victims of natural disasters and other catastrophes. (Art. 195).

5. The Relative Position of Macedonia within CEE Region with Respect to Tax Law Reform

The most recent comparative surveys of the tax laws and regulations relating to NPOs in CEE countries show substantial variety of concepts and solutions to major issues in this area.[14]

According to World Bank's Handbook on Good Practices for Law Relating to NGOs, NGOs should be exempt from income taxation on most kinds of income. This recommendation is a logical consequence from the innate nature of an NGO that precludes the possibility of personal benefit or the distribution of profits. Even income derived from so-called economic activity – although similar to profits of a business company – are reinvested and spent on appropriate non-profit activities.

In CEE countries there is a general practice that every NGO should be exempt from income/profit taxation on contributions, grants

[14] Excellent sources of comparative legislations are: *European Tax Handbook 2002*, International Bureau of Fiscal Documentation – IBFD Publications BV, Amsterdam, The Netherlands. Specifically on tax incentives for NPOs see in: INCL's *Survey on Tax Laws Affecting NGOs in Central and Eastern Europe*, International Center for Not-for-Profit-Law, Washington, DC, 2000.

or donations, proceeds from contracts with governments, and membership dues or fees.

Macedonian tax law does not exempt from profit tax NPOs as legal entities but only implies that particular sources of income shall be exempt from tax, such as proceeds from budgets, funds, designated donations, membership fees etc., strictly used for the legitimate purposes of a legal entity. Through legal interpretation, one may conclude that contributions, grants or donations, proceeds from contracts with governments, and membership dues or fees, satisfy the criteria promulgated in the Law on Profit Tax, and should be exempt from profit tax.

Income from economic activity is a very controversial issue with regard to tax liability of NPOs when they engage in such, for-profit activities for the purpose of additional financing. Various tests are being implemented in different countries for determining whetther (1) the organization is established and operated *primarily* for public benefit purposes ("principle purpose" test), Accordingly, NPO that consistently spent more than fifty percent of its funds or resources would be required to reregister as a for-profit entity. (2) all income from economic activities is spent solely for pursuing the statutory public benefit purposes of the NPO, irrespective of the fact that the income is earned by the NGO directly, or is generated by an other organization -subsidiary or affiliate- (destination of income / no limitation on type of economic activity), (3) the particular economic activity is related to the primary purpose and/or objective of the NPO (relatedness test / possible limitations on level of earnings).

According to Macedonian law NGOs economic activities may be carried out only by a subsidiary company, which is to be taxed as any other for-profit entity. Income from economic activity must be reinvested in the NGO and used solely for the statutory and legitimate purposes, prescribed by its by-laws. The moment income is used for other purposes or is distributed elsewhere, the NGO loses its not-for-profit character, fact that in effect may lead to dissolution of the entity.

Sporadically, from time to time economic activity related to the principle goal of the NGO, may be conducted

Second issue is the taxation of the profit-generating activity. On one extreme are countries that *tax all or substantially all economic and commercial activities.* Ukraine, Bulgaria, Croatia, Romania, Bosnia & Herzegovina, until recently Estonia follow this approach, with Lithuania moving in that direction.

Macedonian tax law does not grant tax-exempt status for subsidiaries of NGOs involved in profit-generating activities.

The second approach is the "destination of income" rule where tax treatment depends entirely upon the use of that income. Countries that apply some of this approach, or in combination to one more test include Poland, Czech Republic, Slovakia, United Kingdom and Ireland.

The "relatedness test" is the third approach, under which income from economic activities that are related to the public benefit purposes of an NPO is exempt from taxation, while all other unrelated income is fully subject to profit tax. This approach to a various degree is in effect in a number of countries: United States, France, Germany,

the Netherlands, and many CEE countries (Bulgaria, Bosnia & Herzegovina, Romania)

In view of the innovative legal developments in the region, having in mind the much praised Hungarian "1% Law", Slovakia following, Lithuania considering, one may freely conclude that Macedonia is in serious delay.[15]

Thus, the overall legal framework in RM only partially correspond to international good practices, and moreover is burdened with a number of weaknesses (unstable, unclear, incomplete, imprecise, inconsistent) the result of which is relatively unfavorable legal and fiscal climate for the growth of the civil society in Macedonia.

6. Conclusion

Macedonia has experienced a renaissances of its half a century *dormant civic society* over the past decade, with several thousand registered organizations, mostly CA and to a considerably minor extent other types of NPOs (primarily foundations). The importance of civic society in such a diverse society, in terms of nationalities, cultures, traditions, religions etc. need not be specifically stressed. It is a condition sine qua non. This fact by itself must present a serious challenge for the legislator and the government as a whole, once the impact of the civic sector is recognized, to facilitate and assist its growth. Taxation is a powerful tool in the hands of governments, to induce changes and sustain positions of the taxpayers under its jurisdiction. Taxes may have positive effects over a sector, or an industry; in other instances they may have negative effects (excessive taxation; double and multiple taxation; taxing the poor ect.), or taxes may simply preserve the situation unchanged – so called neutral taxation.

The expectations for CEE governments and Macedonian government alike, is to establish favorable tax conditions for the "third sector".

The third sector /civic sector/ has enormous diversity, and distinction is often made between organizations that serve principally the interests of their members (MBOs) from those that serve much wider public interest or public good – called public benefit organizations (PBOs). Within each of these large categories there is enormous variety of purposes, sizes and scope, but they all contribute to one identical goal – creation and growth of a vibrant open society. PBOs are actually the type of civic organizations that attract most attention and enjoy fiscal and other state introduced measures.

The analysis of the Law on Associations of Citizens and Foundations (1998) suggests that *de lege lata* regulation appears to be insufficient concerning one very important issue: it fails to provide

[15] Hungary enacted a law in 1996, which permits taxpayers to direct 1% of their taxes to be paid to NGOs designated by them. By providing a simple mechanism for directing funds to NGOs, the "1% Law% creates significant pool of resources -- $9 million in its first year – to support socially beneficial activities. For more details see: INCL's Survey on (.), Ibid. p.4

adequate and detailed provisions on the special type of NPO, i.e. the Public Benefit Organization. Furthermore, this type of NPO – to the contrast of an ordinary NPO – in most countries enjoys preferential fiscal treatment, thus securing the long-term financial sustainability and growth of PBOs. The law is not explicit on this issue. Thus, the fiscal treatment of publicly authorized NPOs will be determined on a "case-by-case" basis, lead by various Ministries.

The Law on Profit Tax does not recognize nor it regulates special "tax-exempt" status of non-profit public benefit organizations. Thus, at present, all legal persons that are registered and have their seat within the territory of RM *and realize profits* are liable for profit tax. Needless to say the scope of "legal personality" encompasses the commercial, business sector and the not for profit, or the sector of the civil society, thus creating an unprecedented practice of equal tax-treatment of two intrinsintly different segments of society. The implementation of the law neglected one decisive legal fact proscribed by the same law, in determining who is liable for profit tax: that is earning profits from operations in RM and abroad. It is hard to believe how could such an obvious fact could have been overlooked by the competent authorities, and almost the entire not-for –profit sector was, contrary to law and internationally recognized principles and practice, subjected to pay profit tax (e.g. State Faculty of Law in Skopje is liable for profit tax!)

The arguments of concerned parties, experts and scholars that the present situation is legally absurd have so far fallen on deaf ears.

The problem could be resolved by one of the following two steps:

(a) The Law on Profit Tax is amended and a new article on "Definitions" is added, where terms like "profits", "taxpayer". etc. are clearly defined and thus distinguishing the civil society organizations from the business (commercial) entities; or

(b) Explicitly, in a separate article, regulating the tax-exempt status of PBO's.

Concerning the legal consistency with the Law on Associations of Citizens (.), it remains that the subsidiary of an PBO organized for profit purposes will in effect have at least equal, if not beneficial, tax-treatment under the provisions of the Law on Profit Tax as other commercial entities.

The long awaited tax-exemptions for charitable contributions by individuals to registered, publicly authorized citizens' associations, by amending the Law on Personal Income Tax in 2006 should be sustained and further strengthened in the future. For example, such tax incentive could be extended automatically to all registered Citizen's Associations with Public Authorization, and to those who are able to prove that their cause is indeed of broad public interest.

Public Revenue Office should carry on regular tax supervision and tax audit of NGOs and their subsidiaries, for preventing practices of tax evasion and all other infringements of tax laws.

A specialized government body, or an independent entity / Commission, Agency, Board or alike/ should be established, mandated to monitor, coordinate, screen and conduct various other

activities related to the operations and conduct of NPOs. This body would preserve the interests of the government and of the general public, ensuring that the organizations granted fiscal preferences, are indeed serving the public benefit cause, and are not used for personal/group gain, nor are pursuing goals that may be harmful to others members of society, or goals that are targeted against government.

Aggressive public campaign should be organized targeted at various segments of the population, especially the young. That would lead to growing awareness and greater concern on issues like charitable giving and volunteer work, on behalf of the new generations. When they gain decision-making power in the economy, the government and in the civic sector, it is likely to expect better understanding for the issues related to NPOs.

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