**The tax reforms in the Republic of Macedonia in the post-recession**

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**ABSTRACT**

A modern tax system and efficient tax administration is the basis for the economic development of each country. Increased workloads, expanded responsibilities and continuing demands for faster and better tax reporting drive tax departments to become more efficient and effective.

The recent reforms of the tax system in Republic of Macedonia which involves lower taxes and modernization of tax administration, should leads to a modern, simple, transparent and fair tax system that contributes to improvement of the business climate in the country. Not only has regulatory and investor scrutiny been heightened, but the corporate governance landscape and the marketplace are also undergoing rapid change. This raises the responsibility of tax accounting in the companies for: embedding best practices throughout the process; optimizing efficiency and use of time; enhancing accuracy and transparency; managing corporate tax risk; improving data management; and strengthening the tax reporting function.

**Key words:** tax reform, modernization, administration, flat tax, effects

**INTRODUCTION**

Republic of Macedonia has faced a number of challenges and difficulties since declaring its independence,[[1]](#footnote-1) pursuing a political and economic reform aimed to build a democratic society and open market economy. One of the most important challenges is the need of new tax policies, which will replace those inherited from socialist regime, designed to promote economic growth through the expansion of private enterprise.

Macedonia as a transition economy is at a crossroads in which it has to choose the appropriate tax policy to follow. Policy makers in Macedonia ought to keep in mind that in a market economy the most fundamental role of the state is to make the market work as efficiently as possible. Companies ranked tax administration among the top five obstacles to doing business. The main factors contributing to this are:

* the large number of business taxes to pay;
* lengthy and complex tax administration;
* complex tax legislation; and
* high tax rates.

**THE EFFECTS OF MACEDONIAN TAX REFORMS**

The Government of Macedonia introduced a number of measures aiming to provide a significant improvement of the conditions for doing business in Macedonia, which are confirmed in the report *Doing Business 2010: Reforming Through Difficult Times*.[[2]](#footnote-2) Doing Business presents quantitative indicators on business regulations and the protection of property rights that can be compared across 183 economies. According to this report and ranging presented in it among the countries, Macedonia noticed improvement for 37 places, and it's ranked as 32.

***Table 1****- Macedonia’s ranking in Doing Business 2010*

|  |  |  |  |
| --- | --- | --- | --- |
| Ease of... | Doing Business 2010 rank | Doing Business 2009 rank | Change in rank |
| Doing Business | 32 | 69 | 37 |
| Starting a Business | 6 | 13 | 7 |
| Dealing with Construction Permits | 138 | 151 | 13 |
| Employing Workers | 58 | 122 | 64 |
| Registering Property | 63 | 88 | 25 |
| Getting Credit | 43 | 41 | -2 |
| Protecting Investors | 20 | 88 | 68 |
| Paying Taxes | 26 | 28 | 2 |
| Trading Across Borders | 62 | 63 | 1 |
| Enforcing Contracts | 64 | 62 | -2 |
| Closing a Business | 115 | 131 | 16 |

Source: Doing business database

The good-practice economies are identified by their position in each indicator as well as their overall ranking and by their capacity to provide good examples of business regulation to other countries. As can be see one of the fields of improvement in Macedonia is paying taxes. For example, one of the tax policy reforms in Macedonia was implementation of flat tax. Also in recent years the flat-tax revolution became popular among the other transition countries. Flat-rate taxes have many merits but they can be applied with low rates, as in Georgia, Russia and the Ukraine, or with high rates as in Lithuania. Therefore, the fact that a country adopts a flat-tax system does not tell us much about the level of taxation in that country or the effective tax burden. It may not even tell us much about the complexity of the system. While talking about tax levels it is important for Macedonia to have some "reference point" as to the "acceptable" (or growth-conducive) level of taxation at this stage of economic development. This reference point can be provided either by the levels of taxation of other countries at present (cross-section analysis) or by the history of tax burden in Macedonia (time series analysis).

In addition we give a sample of empirical data where we can see the level of specific taxes in Macedonia comparable with the developed and transition economies.

***Table 2*** *– Rates of specific taxes in developed and transition economies*

|  |  |  |  |
| --- | --- | --- | --- |
| **Country** | **Corporate tax** | **Maximum Personal Income tax** | **VAT** |
| Austria | 25% | 50% | 20% |
| Belarus | 24% | 30% | 18% |
| Belgium | 34% | 50% | 21% |
| Bulgaria | 10% | 10% | 20% |
| Croatia | 20% | 45% | 23% |
| Czech Republic | 21% | 15% | 20% (10% on selected good and services) |
| Estonia | 20% | 21% | 20% (9% on selected goods and services) |
| Finland | 26% | 53% | 22% |
| France | 3.33% | 40% | 19.6% (2.1% drugs, newspapers, theatres), (5.5% raw food, books) |
| Germany | 15,825 % (federal) plus 14,35 % to 17,5 % (local) | 45% | 19% (7% on selected goods and services) |
| Georgia | 20% | 12% | 18% |
| Greece | 25% | 40% | 21%(11% on selected goods and services) |
| Hungary | 16% | 36% | 20% |
| Iceland | 26% | 45.58% | 25.5% |
| Italy | 37.25% | 45% | 20% (10% and 4% on selected goods and services) |
| Latvia | 15% | 23% | 21% (10% certain goods and services) |
| Lithuania | 20% | 21% | 21% |
| Macedonia | 10% | 10% | 18% (5% VAT on food, medicine, IT technology and other products) |
| Malta | 35% | 35% | 18% (0% VAT on food and medicine) |
| Montenegro | 9% | 15% | 17% (7% for certain goods and services) |
| Netherlands | 25.5% | 52% | 19% (6% for certain goods) |
| Poland | 19% | 32% | 22% (some products i.e. food - 7%) |
| Romania | 16% | 16% | 19% |
| Russia | 24% | 13% | 18% |
| Serbia | 10% | 14% | 18% (8% basic necessities as bread, milk etc.) |
| Slovakia | 19% | 19% | 19% |
| Slovenia | 22% | 41% | 20% |
| Sweden | 26.3% | 55% | 25% (12%/6% for certain goods and services) |
| Switzerland | 25% | 45.5% | 7.6% |
| Turkey | 20% | 35% | 18% |
| Ukraine | 25% | 15% | 20% |
| United Kingdom | 21%-28% | 50% | 17.5% (some items at 5%, some items 0%) |

Source: Eurostat

As we can see Macedonia has the lowest tax rates compared to the developed and transition countries.

The data below shows the tax that a medium-size company in Macedonia must pay or withhold in a given year, as well as measures of the administrative burden in paying taxes (Table 3). The main indicators of paying taxes are: the total number of payments per year; the time it takes to prepare, file, and pay (or withhold) the corporate income tax, the value added tax and social security contributions (in hours per year); and the total tax rate, which measures the amount of taxes and mandatory contributions payable by the business in the second year of operation, expressed as a share of commercial profits.

***Table 3*** *– Main indicators for paying taxes of Macedonian’ enterprises*

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Tax or mandatory contribution** | **Payments (number)** | **Time (hours)** | **Statutory tax rate** | **Tax base** | **Total tax rate (% profit)** | **Notes on TTR** |
| **Corporate income tax** | 12 | 25 | 10.0% | taxable profit | 12.1 |  |
| **Property transfer tax** | 1 | - | 3.0% | sale price | 1.8 |  |
| **Fuel tax** | 1 | - | 24.396/liter | liter consumption | 1.6 |  |
| **Additional health contribution and water contribution** | 12 | 28 | 0.7% | gross salaries | 0.8 |  |
| **Municipal fee** | 1 | - | fixed fee (MKD 8,000) |  | 0.1 |  |
| **Property tax** | 1 | - | 0.1% | land value | 0.1 |  |
| **Value added tax (VAT)** | 12 | 22 | 18.0% | value added |  | not included |
| **Totals:** | 40 | 75 |  |  | 16.4 |  |

Source: Doing Business database

The mitigation in administrative burden of paying taxes and contributions is confirmed from the comparative historical data and practice in other countries (Table 4, 5 and 6).

***Table 4*** *– Historical data for administrative burden of paying taxes*

|  |  |  |  |
| --- | --- | --- | --- |
| **Paying Taxes data** | **Doing Business 2008** | **Doing Business 2009** | **Doing Business 2010** |
| **Rank** | --- | 28 | 26 |
| **Total tax rate (% profit)** | 21.6 | 18.4 | 16.4 |
| **Payments (number per year)** | 40 | 40 | 40 |
| **Time (hours per year)** | 96 | 75 | 75 |

Source: Doing Business database

***Table 5*** *– Comparative date for administrative burden of paying taxes and contributions*

|  |  |  |  |
| --- | --- | --- | --- |
| **Indicator** | **Macedonia, FYR** | **Eastern Europe & Central Asia** | **OECD Average** |
| Payments (number per year) | 40 | 46.3 | 12.8 |
| Time (hours per year) | 75 | 336.3 | 194.1 |
| Profit tax (%) | 12.1 | 10.9 | 16.8 |
| Labor tax and contributions (%) | 0.8 | 23.1 | 24.4 |
| Other taxes (%) | 3.5 | 9.4 | 3.3 |
| Total tax rate (% profit) | 16.4 | 43.4 | 44.5 |

Source: Doing Business database

***Table 6*** *– Paying taxes date for Macedonia compared to good practice and comparator economies*

|  |  |  |  |
| --- | --- | --- | --- |
| ***Selected Economy*** | **Payments**  **(number per**  **year)** | **Time (hours**  **per year)** | **Total tax rate**  **(% profit)** |
| **Macedonia** | 40 | 75 | 16.4 |
| **Bulgaria** | 17 | 616 | 31.4 |
| **Turkey** | 15 | 223 | 44,5 |
| **Croatia** | 17 | 196 | 32.5 |
| **Czech Republic** | 12 | 613 | 47.2 |
| **Hungary** | 14 | 330 | 57.5 |
| **Montenegro** | 89 | 372 | 28.9 |
| **Slovak Republic** | 31 | 257 | 48.6 |

Source: Doing Business database

The comparative analysis of tax payments show the competitive advantage which Macedonia has in regard to other countries, especially in time needed for preparing, completing and filing tax returns, and participation of taxes and contributions in commercial profits of companies. In future tax authorities should pay attention to reducing frequency of tax payments.

When it comes to speak about reducing the rates of taxes and facilitating the process of paying them, we also need to consider the effects of such measures on collection of tax revenues from the state. Bellow we exhibit the data concerning the movement of revenue from each tax (profit tax, personal income tax, VAT and excise) and changes made in total tax revenue (Table 7).

***Table 7****- Realized Tax Revenues for the period 2003 – 2009 in Macedonia*

*- amounts in million denars*

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **TAX REVENUES** | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2009** |
| **PT** | 3,270.09 | 2,362.16 | 2,835.79 | 4,709.83 | 5,896.45 | 8,579.00 | 4,434.00 |
| **PIT** | 7,502.5 | 7,706.71 | 8,098.70 | 8,413.82 | 8,890.91 | 8,696.00 | 8,707.00 |
| **VAT** | 21,175.92 | 25,756.85 | 27,081.13 | 27,240.31 | 32,962.05 | 36,174.00 | 35,178.00 |
| **EXCISE** | 10,565.15 | 10,336.36 | 11,090.92 | 11,511.41 | 12,583.80 | 13,557.00 | 13,789.00 |
| **TOTAL** | **42,545.41** | **46,161.85** | **49,107.27** | **51,875.62** | **60,333.23** | **67,006.00** | **62,108.00** |

Source: Ministry of finance

As we can see the total tax revenues for the period 2003-2008 shows an increasing trend. The total increase is 32%. Increasing the revenues is particularly pronounced in 2006, 2007 and 2008. This is a result of several factors: lower tax rates have been accompanied by increasing the tax base; lower tax rates have stimulated many companies to legalize their business and pay taxes; increased efficiency of tax authorities in collecting the revenues; and increased economic activity accompanied by increased investment and new businesses. This positive trend was interrupted in 2009. In this period is registered fall in revenues to 7.5%. The reduction in tax revenues during this period is a result of global economic and financial crisis which has not remained immune Macedonian economy. Approval for this is the fact that the decrease is primarily due to lower revenues from profit tax (47%) and value add tax (2.8%), which is a consequence of declining profitability and economic activity of enterprises. A certain contribution to reducing the revenues has the taken antirecession measures by Government with intention to reduce tax burden on companies in order to mitigate the damages from the current crisis.

Besides fiscal implications for the budget, it must be taken in consider the effects that lower taxes have on companies directly. This is of particular importance because from the companies ultimately depends on whether the intention to create conditions for job creation, investments and increased production will become a reality. Center for Economic Research conducted a survey on a sample of one hundred companies from different industries.[[3]](#footnote-3) All of the gathered general information has been cross-tabulated with five different characteristics of the companies i.e.: the average number of employees of the company; the annual income of the company; the average value of the overall assets of the company; the type of ownership of the company; and the type of activity of the company (sector).

In addition, we present the results obtained in this study observed in several areas of working on which tax reforms affect:

* The introduction of tax reforms have enabled the companies to improve their liquidity;
* Tax reforms increased the profitability of companies;
* Tax reforms simplified the calculation and reporting of fiscal obligations;
* The introduction of tax reforms exhibited moderate effects on job creation;
* Tax reforms moderately stimulated companies' investment;
* The tax reform improves the business environment, but there are other important aspects to be dealt with;
* 28% of the respondents consider the tax reform as a strong impetus for FDI inflows in the Macedonian economy;
* Mixed support for the new policy for stimulating the reinvestment of profits;
* There is overwhelming impression that the overall tax burden has been reduced
* Political party protection of privileged companies, high labor costs and poor quality of the public services highlighted as the main reasons for tax evasion in Macedonia;
* Moderate progress in reporting the exact number of employees;
* 15% of the respondents expects substantial progress in downsizing the informal economy;
* Nearly half of the companies reported that the changes in Macedonian tax legislation were too frequent;
* Strengthened tax inspections are the most important factor behind the buoyant tax revenue collection.

**CONCLUSION**

There is a great consensus in the view that the design of the tax system can have significant microeconomic impacts.

The fiscal package introduced by the Government of Republic of Macedonia has improved the business environment. The elimination of progressive personal income tax, the reduction of corporate tax, the zero tax rate on reinvested earnings, VAT system restructuring with broadened 5% tax base are primarily focused on increasing corporate and personal income and stimulating saving, investment, job creation and productivity growth.

The surveys results indicate that despite the initial success of the tax reform there is still more to be done in the tax legislation and the preparation of legislative changes. Profitability and liquidity of the companies should not count on further fiscal stimulations; further reduction of the statutory tax rate could send a different signal to foreign investors instead of improvement of the business climate itself.

Further simplifications should be envisaged in terms of reporting made by taxpayers to the Tax Administration and tax administration procedures to be as much as possible simple, precise and with less bureaucracy involved. The way in which tax authorities are attempting to simplify compliance for business is through the better use of technology in order to achive electronic filing of returns. An increasing number of taxpayers are availing themselves of such facilities, a trend which will ensure swift repayment on the investment made by tax authorities through improved administration efficiencies. The intention is to establish a methodology which would enable companies to collect and report total tax information in a consistent manner, meeting the needs of their various stakeholders and improving transparency. There is a need for more transparency so that all relevant stakeholders, governments, employees, shareholders and investors, the media, and society at large can see the contribution companies are making to their local economies and help them to communicate their positive economic impact.

Tax legislation is subject to changes too frequently. It must be consider a rewording of the texts of the tax laws and preparing comprehensive texts which could contribute to more precise provisions and avoid further small and partial changes in the laws. Particular emphasis should be given to international aspects of the taxation as more and more foreign companies are present in Macedonia. Tax rules should be reconciled to those internationally recognized rules. Since the Company Law requires the use of International Financial Reporting Standards (IFRS) in the annual accounts of large and medium size commercial entities, it must assess the impact of IFRS on the degree of accounting competence required of tax inspectors.

Further development of the Tax Administration in terms of human resource management and strengthening of the knowledge base is needed. The Public Revenue Office must improve the audit performance and build a reputation of institution subject to less political influence and less corruptive elements. The politically independent approach will contribute to more efficient administering of the tax laws and greater capacity to deal with the new challenges of taxation, communication with other countries' tax authorities and harmonization with the EU Directives.

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