

NOVELTIES IN THE IMPLEMENTATION OF THE LAW ON VALUE ADDED TAX AND THEIR IMPACT ON THE WORK OF CIVIL SOCIETY ORGANIZATIONS

Are Individuals VAT Taxpayers?

Public Policy Document

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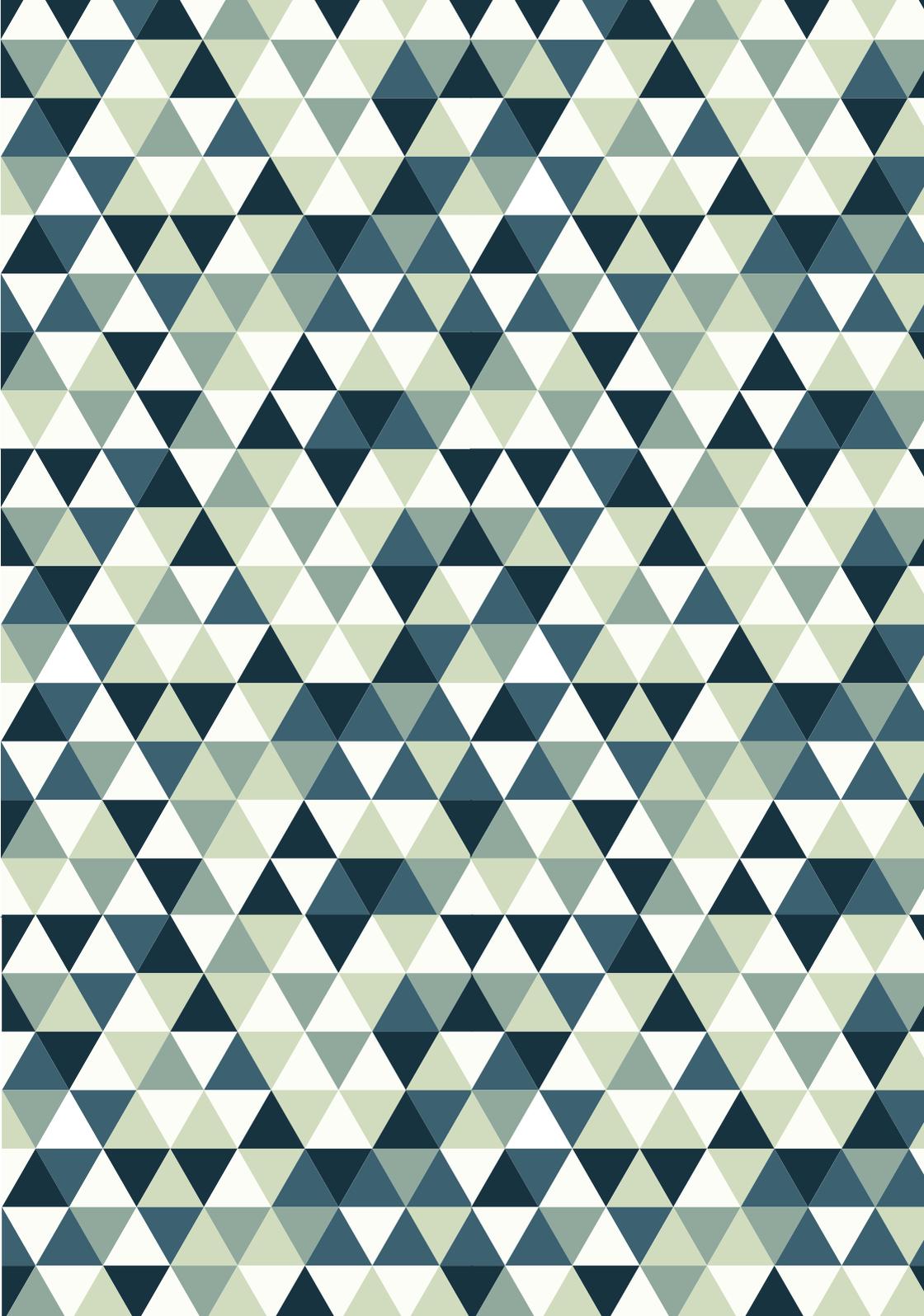
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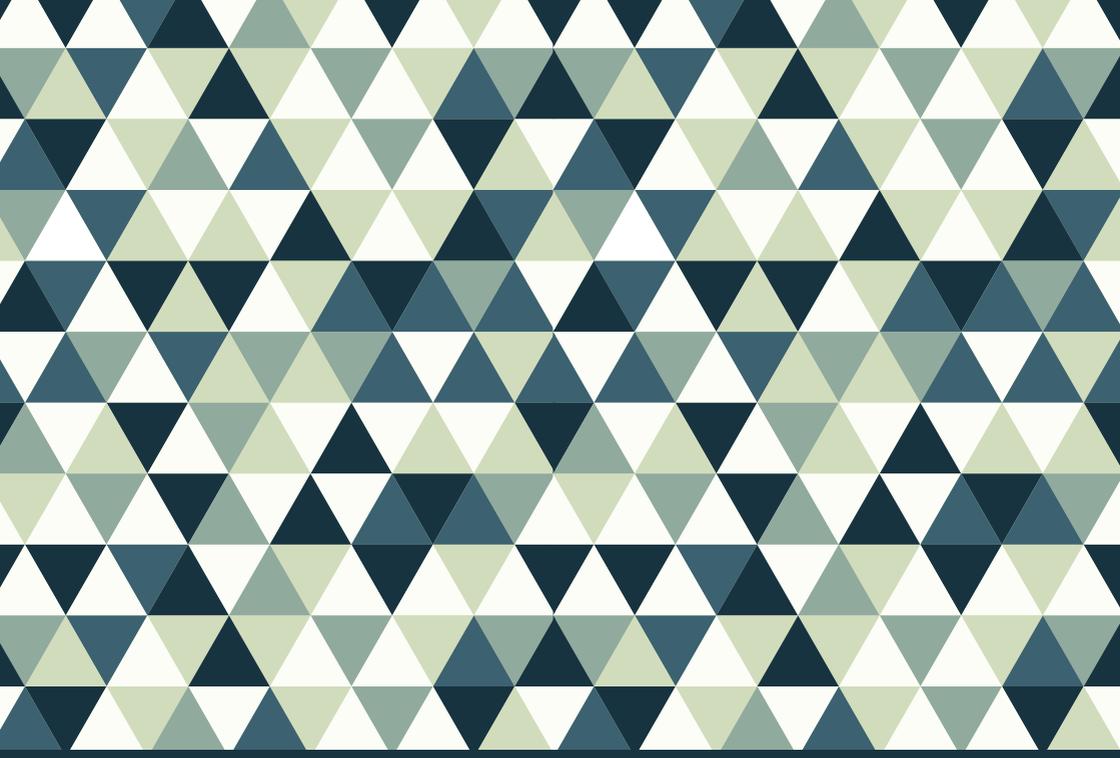
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EXECUTIVE SUMMARY

In January 2018 the Public Revenue Office¹ (hereinafter: PRO) announced that all individuals who performed economic activity taxable for VAT purposes and as a result, in 2017 achieved a total turnover over 1.000.000 denars are obligated to register as taxpayers for VAT purposes.

According to the PRO, the total turnover for obligatory VAT registration includes the income generated on the basis of performing economic activity, such as the activities of expert witnesses and bankruptcy trustees, income from agricultural activity, income generated on the basis of temporary service contract, income from property and property rights, income from copyrights and industrial property rights, income from membership in supervisory boards, etc.

This interpretation of the relevant provisions of the Law on VAT, which have been introduced and implemented since the distant 2000, has caused major reactions between experts and the academia, as well as the civil sector. Several public debates and analyzes were held or published that pointed out some weaknesses of the legal framework and the consequences of the so-called extended interpretation of these provisions. Essentially, the key issue is the broader meaning of the terms "taxpayer" and "business activity" that could provide arbitrarily in the law application and violation of the principle of legal certainty and the rule of law.

The latest developments, which have occurred since the beginning of this year, are directly related to the reduction of the amount of turnover for obligatory registration of taxpayers for VAT purposes, enacted by the amendments to the Law on VAT². The intervention in the amount of VAT turnover was made without implementation of the process of regulation impact assessment, which caused public reactions.

This public policy document (hereinafter: the Document) fills the gap in the implementation of the process of impact assessment of the regulation, which the Ministry of finance was obligated to implement in the Law amendments from 2014. Hence, through the: analysis of the current situation (see section 3), identified and analyzed problems regarding their social implications (see section 4) and given recommendations (see section 5), the Ministry of finance is supported and encouraged to take steps forward harmonization of Macedonian legislation in the field of taxes and tax policy with the EU law and the tax legislation in the NATO member states. Moreover, the document indicate the need for organization and implementation of the process of impact assessment of the regulation that will include all stakeholders who

1 Public Revenue Office, brochure, [Registration and VAT taxation of individuals](#), 2018.

2 Official Gazette of RM, No.130/2014 from 3.9.2014.

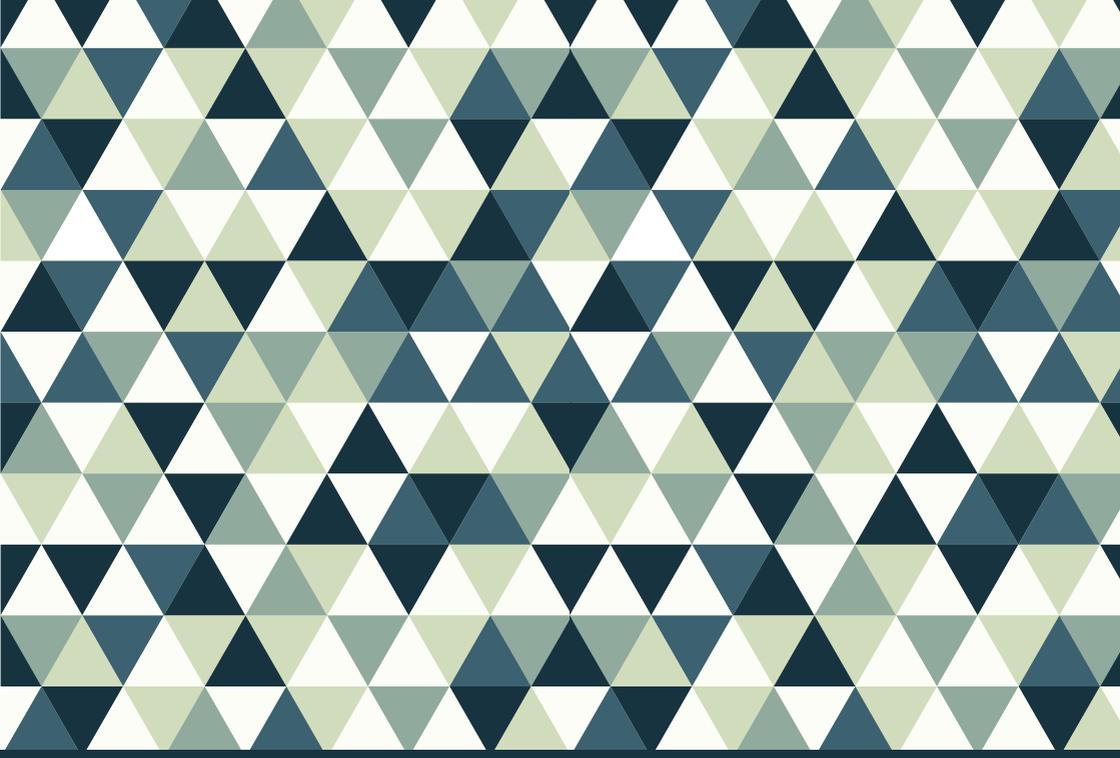
will be able to help in providing the most practical, functional and, above all, easily applicable solution, and in the context of the principles of good governance (transparency and openness, effectiveness and efficiency, compliance and accountability).

Hence, this document gives an analysis on the problem caused by the obligation of the individuals to register as taxpayers for VAT purposes, through its implications on the work of the civil society organizations and the performance of activities in public interest. The Document analyzes the legal framework concerning the VAT obligations of the individuals and civil society organizations and gives recommendations for their overcoming.

The comparative analysis of the EU standards, introduced in the **EU Directive 2006/112 / EC (the VAT Directive)** and in the tax systems of the countries from the region, showed that individuals are not separated from the VAT system. However, there are certain so-called border cases that require clear and precise legal framework that would determine whether or not the conditions for registration of individuals as VAT taxpayers are fulfilled. Such "border cases" were unfortunately also present in the previously mentioned PRO's announcement, which stated that all incomes from copyrights (whether there is a transfer or deviation of rights) and from membership in a supervisory boards were qualified as an economic activity.

This Document identifies and addresses as crucial the following problems: (1) imprecise legal framework with regard to the definitions of the terms "taxpayer" and "economic activity"; (2) too low amount of VAT turnover; (3) too long period in which the VAT taxpayers remain registered for VAT purposes; (4) lack of clear provisions regarding the right to deduct the previous tax.

The identified problems can be overcome through: (1) harmonization of the Law provisions that define the terms "taxpayer" and "economic activity" with the EU Directive 2006/112 / EC (the VAT Directive); (2) harmonization of the Law provisions regarding the tax exemptions without right to deduct the previous tax with the EU Directive 2006/112 / EC (the VAT Directive) – public interest; (3) Amendments to the Regulation for implementation of the Law on VAT that will elaborate the Law provisions regarding the terms "taxpayer" and "economic activity"; (4) bringing back the previous amount of VAT turnover, from 1.000.000 to 2.000.000 denars; (5) reduction of the period of time for VAT obligatory registration from five to three years.



1. INTRODUCTION



The Document provides an analysis of the legal framework that establishes and regulates the obligation of individuals that fulfill certain conditions, to be registered as VAT taxpayers. Additionally, the document analyzes the Law application by the tax authorities³, as well as the implications of the registration of individuals as VAT taxpayers in relation to the work of civil society organizations in the context of their VAT obligations.

The purpose of this Document is dual: 1) to identify if and to what extent the current legal framework and tax policy regarding the individuals as VAT taxpayers is clear and precise to provide predictability and legal certainty for the individuals as potential taxpayers, efficient tax system and fair conditions for doing business, and 2) to fill the gap in the implementation of the process of impact assessment of the regulation, which the Ministry of finance was obligated to implement in the Law amendments from 2014 that reduced the amount of VAT turnover and to encourage the Ministry to begin an implementation of the process of impact assessment of the regulation for harmonization of the recent Law on VAT with the EU law.

This Document is developed within the project “*Action against tax plus*” implemented by the Center for Legal Research and Analysis, in cooperation and supported by the Institute for Democracy “*Societas Civilis*” - Skopje, and with EU financial support. The focus of this project is the obligation of the individuals whose turnover exceeds 1,000,000 denars over one calendar year to register as taxpayers for VAT purposes. The project aims to provide evidence-based recommendations intended to reduce the financial implications on the work of the civil society organizations through a comprehensive impact assessment of the regulation that directly affects the normal functioning and sustainability of the civil society sector.

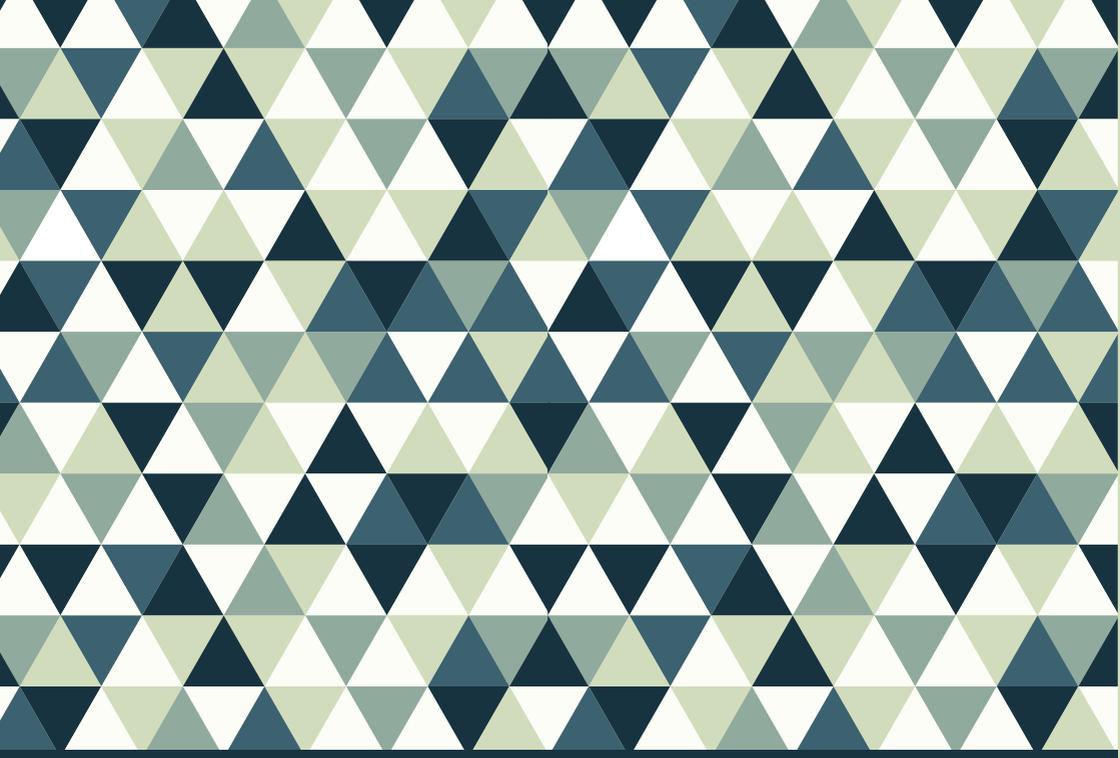
Specific objectives of this Document are: 1) identification of the implications of VAT taxation of individuals, 2) the legal framework and possible negative aspects and consequences of its practical implementation, 3) assessment of the level of harmonization of Macedonian legal framework with the EU law. This Document provides recommendations for overcoming the practical problems, by identifying the implications and possible negative aspects, based on the best practices from the region, which at the same time could be applied in the Macedonian context.

The Document offers legal analysis of the norms and rules that regulate the taxation of individuals whose total turnover exceeds one million denars in one calendar year. By clearly identifying the inconsistencies or possible legal gaps - it will facilitate the formulation of appropriate amendments (based on

3 The Public Revenue Office of Republic of Macedonia.

analysis and research and best comparative practices) in the present legal and legislative framework, which will ultimately result in proper VAT treatment of the individuals.

During the research conducted for the necessity of drafting this Document, analyzes and papers done so far by experts and the academia have been taken into consideration, with a special focus on the analyzes carried out by the civil sector in the last year, which contributed this issue to be actualized.



2. METHODOLOGY

During the preparation of this Document, the guidelines and structure for preparation of public policy documents are followed, as proposed in the Guide “How to Effective Public Policies”⁴. At the same time, the structure of the Report for the Impact Assessment of the Regulation with an instruction for fulfilling⁵ was followed in order to respond to the needs of the Ministry of finance in terms of undertaking activities to overcome the identified problems.

The following tools were used for collecting data:

- Analysis of regulations and relevant literature⁶,
- Conducting semi-structured interviews with experts in the field of tax law and tax policy and
- Implementation of two semi-structured focus groups with representatives of civil society organizations.

In the process of preparation of this document, a **descriptive method** was used by describing the current situation and the characteristics of the main subject of the Document. During the collection of data, a combined **analytical-synthetic** approach was used, while a **comparative method** was used to determine and identify the best practices from the region. The application of a combined analytical-synthetic approach and a comparative method for comparing data and findings contributes to a wider perspective and more detailed insight into the legal solutions of other tax systems, introduced as a result of the specific needs of these countries.

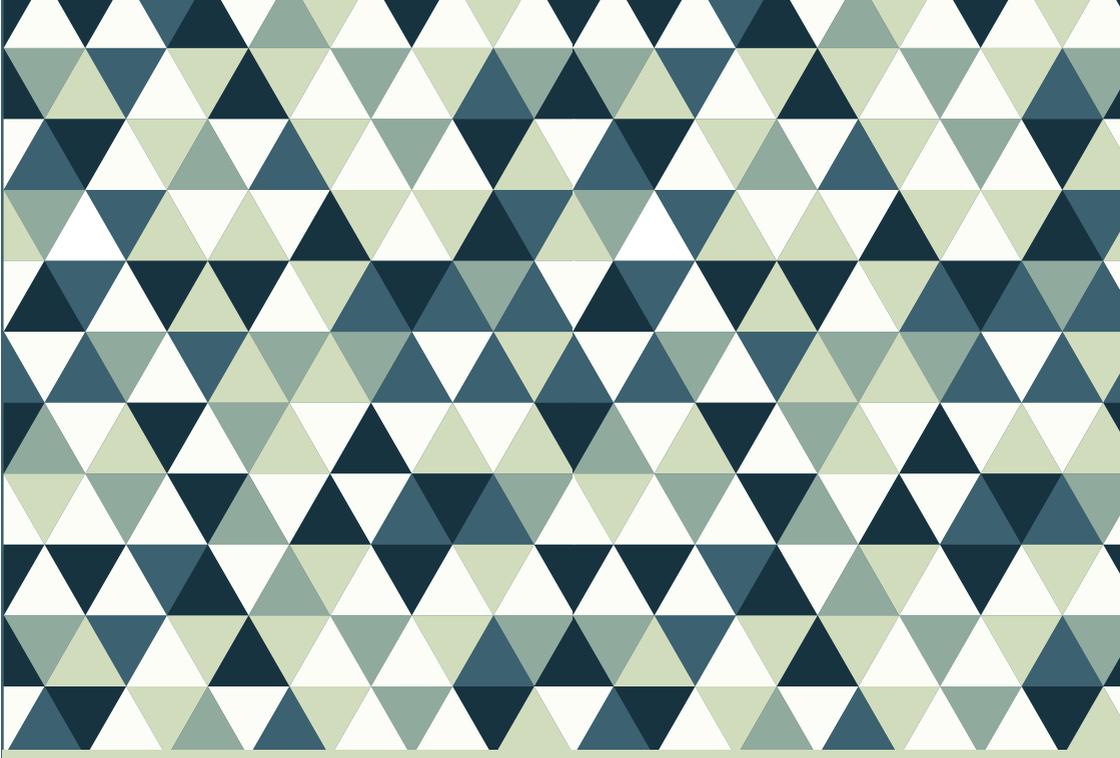
The Document contains views, perceptions and opinions gained through organized and conducted **interviews**, consultative meetings and focus groups with experts, practitioners and theorists in the area of tax law and policy. In the period from June to the beginning of August 2018, six interviews were conducted with: Professor of Economics; Slavko Lazovski, tax expert; representative of the Ministry of finance; Elena Neshovska Kjoseva, Assistant Professor at the Faculty of Law “Iustinianus Primus” - Skopje, Department of Financial Law; Zharko Hadzi Zafirov, a lawyer from Skopje, and Blagica Petrova from the Association of Economic Researchers. For the purpose of carrying out the interviews, a semi-structured questionnaire was prepared with pre-defined questions and topics that should be addressed in order to

4 Young E. & Quinn L. Writing Effective Public Policy Papers - A Guide for Policy Advisers in Central and Eastern Europe © 2002 Open Society Institute. Budapest.

5 The Report is available at <http://www.mio.gov.mk/?q=mk/node/1484>

6 Summary of analyzed regulations and literature is given in the section References in the Document.

understand better the local context and the legal challenges regarding the problem of VAT taxation of individuals. Interviews were conducted according to the methodology of obtaining individual consent for participation in the research. At the same period, two focus groups with representatives of civil society organizations were conducted in participative manner. The aim of these focus groups was to note all the implications on the work of the civil sector in the analyzed area. The participants kept their anonymity on the conducted focus groups, representing the views of the Association of Economic Researchers, Human Rights Institute, Coalition "All for Fair Trials", the Youth Educational Forum, the Institute for Democracy Societas Civillis - Skopje, ...



3. INITIAL REMARKS ON THE PROCESS OF REGULATION IMPACT ASSESSMENT

The process of impact assessment of the regulation is a set of activities, where the analysis is carried out, relevant data are collected in order to estimate the best possible solutions of the problem by comparing the possible solutions in terms of their financial applications and in terms of achieving the objectives set up with the Law proposal, as well as compulsory involvement of consultations with the stakeholders.

Chronologically, it is about implementation of regulation impact assessment (hereinafter: RIA) since 2009, with major reforms in this area in 2011, which continued in 2014 with development and improvement of the functioning of the Single National Electronic Register of Regulations (SNER). In the relevant literature, SNER is rated as the strongest feature of the system for implementation of the process of impact assessment of the regulation⁷.

For the purpose of prescribing the way of performing of the ministries in implementation of the process of impact assessment of the regulation, at the session held on 23.07.2013 the Government of the Republic of Macedonia adopted the Guideline, which introduced the form and the content of the Regulatory Impact Assessment Report, which has to be prepared by the ministries that propose laws. On the same session, the Government adopted the Methodology for Regulatory Impact Assessment, which unambiguously established that the quality implementation of the RIA process contributes to effective and efficient law implementation, and as a result, realization of the Macedonian Government's policies.

The Regulatory Impact Assessment Report contains certain elements that are important for fulfilling the good governance principles, especially due to the fact that this report should be published on the SNER and on the Ministry's website. Thus, the report contains⁸:

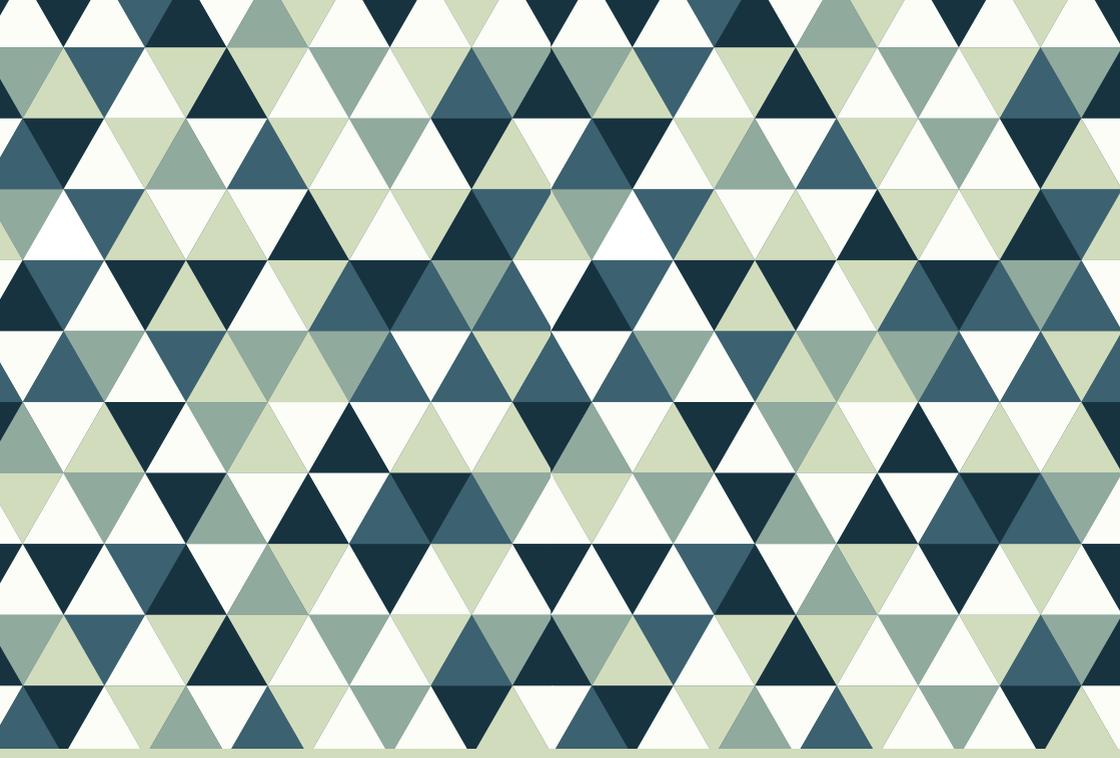
1. Description of the situation in the analyzed area and definition of the problem - this section provides a description of the situation in the analyzed area, including the relevant regulation in the area or other related areas, as well as other programs / projects of the Macedonian Government that are being implemented. Additionally, the explanation of the *raison d'être* for the analyzed problems is given.
2. Objectives of the draft regulation - Indicate the expected / desired goals and effects that the draft regulation should achieve.

⁷ Ibid., Bliznakovski, Jovan, Public policy document, April 2017, Comparative good practices for implementation of impact assessment process and possibilities for their implementation in Macedonia, available at: <https://goo.gl/4t9C8Q>

⁸ Appendix no.1 of the Guideline for the way of performing of the ministries in the process of implementation of the regulation impact assessment, Official Gazette of RM, 106/2013 from 29.7.2013.

3. Possible solutions (options) - at least three possible solutions, including the option "Do nothing". For the "Do nothing" option, a description of the consequences is given in terms if the government does not intervene with Law proposal or other measure. Other solutions that have been considered in the process must be described in details giving their content, the manner of their implementation as regulatory measures or non-regulatory measures or as combination of both.
4. Regulation impact assessment - the assessment should be carried out thoroughly in terms of economic, fiscal, social, environmental and administrative effects and costs.
5. Consultations with stakeholders and means of involvement with mandatory inclusion of their proposals and opinions, as well as review of opinions that were not taken into account and the reasons for that decision.
6. Conclusions and recommended solution - include a comparative overview of the positive and negative impacts of the possible solutions (options), as well as their risks in the process of implementation and application, that justified the reasons why the chosen solution is recommended.
7. Implementation of the recommended solution - this section describes whether the selected recommended solution would require the need to change the legal framework, by identification and declaration of these changes and deadline assessment for their adoption. In addition, this section states the administration bodies, institutions and other organizations responsible for realization of activities for ensuring efficient implementation of the Law proposal.
8. Monitoring and Evaluation - perhaps one of the most important part of the RIA Report that contains a description of the process of monitoring of the implementation and the accomplishment of the effects of the regulation and indicates the administration authorities that would be involved in the monitoring process; as well as a description of the evaluation of the regulation's effects and the timeline for implementation.

Given the strong public reaction caused by the amendments to the Law on VAT and the actions that were undertaken by the PRO in the last year, we can conclude that regulation impact assessment for these changes was not done, which further imposed number of problems, as main subject of this Document.



4. DESCRIPTION OF THE VALUE ADDED TAX LANDSCAPE

4.1 Introduction of the value added tax in the Republic of Macedonia

The Parliament of the Republic of Macedonia adopted the Law on VAT on July 14, 1999, and entered into force in January the 1st, 2000. The main reason for the VAT introduction and the replacement of the previous sale tax on goods and services in the retail trade with multi-phase tax on the added value generated by economic activity, was the need to promote and expand the market and the economic relations between Republic of Macedonia and the EU in the period of signing the Stabilization and Association Agreement (SAA). VAT, as a type of consumption tax due to its advantages, is accepted as EU standard and, as a result, the Union is making efforts to harmonize the national laws through the so-called VAT Directives. The VAT introduction in the Macedonian tax system was a challenge for the individuals and legal entities VAT taxpayers, and particularly for the tax authorities⁹. As a result, the Law introduction was postponed for an additional three months¹⁰.

During the process of creation and incorporation of the VAT in the Macedonian tax system, the Macedonian legislator applied the basic principles established by the 6th EU VAT Directive¹¹, which now establishes a net tax on consumption by applying the tax credit method, entirely compatible with the European VAT model. According the introduced VAT model, all products and services are taxed with a single tax rate in all phases from production till the final consumer, whereby the tax is paid only on the added value (newly created) of the product or the service in each stage of the production, trade and agriculture, or the net value, which prevents the cumulative effects of taxation. Hence, a system of taxation of the supply of goods and services and imports, considered as superior in the tax legislation, has been introduced, but requires a consistent application of the rules for its proper functioning.

9 Pendovska, V. & Neshovska Kjoseva, E., *Individuals as VAT taxpayers, Legal Analysis on the Law amendments: dilemmas and challenges*, Annual of the Faculty of Law "Iustinianus Primus" – Skopje in honor of Prof. Gale Galev, 2018.

10 Law on amendments to the Law on VAT, Official Gazette of RM, 86/1999 from 31.12.1999.

11 Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment

4.2 Explanation of the VAT system in the Republic of Macedonia¹²

VAT is a tax on general consumption, calculated and collected during all stages of production and supply of goods and services. Subject to taxations are: (1) supply of goods and services which is carried out with compensation in the country by the taxpayer within the scope of his economic activity; and (2) importation of goods. VAT taxpayer is every person who permanently or periodically independently conducts economic activity, regardless of the goals and the results of that activity. VAT tax base is the total amount of compensation received, or is supposed to be received for the turnover, in which the VAT is not included. VAT is calculated by applying two proportional tax rates – one general tax rate of 18% and one preferential tax rate of 5%. According the Law on VAT, there are two types of tax exemption in the country, with and without the right of deduction of the input tax.

The taxpayer has to register for VAT purposes. The Law recognized compulsory and voluntary VAT registration. The VAT registration is obligatory for taxpayers who in the preceding calendar year had a turnover higher than 1.000.000 denars, taxpayers who during the calendar year achieve a total turnover over 1.000.000 denars and taxpayers who are beginning with carrying out of an economic activity, if they predict that they will achieve turnover over 1.000.000 denars. The voluntary registration is enabled for VAT purposes if in the past calendar year the taxpayer realized a turnover lower than 1 million denars annually and if the taxpayer begins to perform economic activity, but because of the amount of the supposed turnover is not obligated for VAT registration, which means that he suppose that would have a turnover of less than 1 million denars, but still may voluntarily register for VAT purposes.

VAT taxpayers have rights and obligations by the Law. They have the right to deduct the previously paid VAT. On the other hand, they are obligated to issue invoices, to declare VAT, to submit VAT return and to pay the tax to the State.

The Law implementation is regulated by the Regulation for implementation of the Law on VAT, but this legal act does not examine and define the key terms that determinate whether one individual or legal entity is VAT taxpayer, the terms “*taxpayer*” and “*economic activity*”.

12 The given explanation is based on the Law on VAT and its amendments.

4.3 Amendments to the Law on VAT and the necessity for its harmonization with the EU law

The Law on VAT is applied for 18 years, along with its 26 amendments and two decisions of the Constitutional Court of the Republic of Macedonia that abolished certain Law provisions. The changes and amendments were mainly interventions in relation to tax rates, tax exemptions and administrative rules, as well as several changes of the amount of the total VAT turnover (at the beginning of the Law implementation the total turnover was amounted to 1.000.000,00 denars; ten months later it was increased to 1.300.000,00 denars; then after 9 years, i.e. in 2010, it was again increased to 2.000.000,00 denars, and finally the last change, that decreased the total turnover, was made in 2014 and at the moment the amount of the total VAT turnover is 1.000.000,00 denars). Additionally, the amendments introduced a special Large Taxpayers Office at the PRO, the VAT tax period were changed to calendar month and calendar quarter, and some other related interventions. In the scientific papers, these interventions are assessed as necessary imposed by the recommendations for harmonization with the EU VAT legislation and that the amendments are generally part of the overall economic policy and relevant to the current changes in the EU VAT legislation.

“The main weakness of this Law is the fact that since its introduction it has been amended for 26 times, which causes some difficulties in the process of the Law implementation. On the other hand, some provisions of the Law are not clear and precise enough and this raises some tax compliance problems for the taxpayers. Additionally, the situation is getting worse by the frequent opinions and interpretations of the Public Revenue Office, which in any case are not and should not be source of law and it is necessary to terminate this bad practice as soon as possible.” – Elena Neshovska Kjoseva, Assistant Professor at the Faculty of Law “Iustinianus Primus” – Skopje, interviewed on 12.7.2018.

The European Commission Progress Report from 2014¹³ stressed out that the Law on VAT, although adjusted, still could be further harmonized, while in regard to the gray economy and the efforts made for its reduction, it was noted as a challenge. The given conclusion addressed the need to develop and establish a system of good documentation for monitoring the payment of VAT refunds, as well as further efforts to combat tax fraud, tax evasion and the gray economy. In the 2015 European Commission Progress Report

13 European Commission. The former Yugoslav Republic of Macedonia – [Progress report 2014](#)

for the Republic of Macedonia¹⁴, the Commission noted that, among other things, the country should continue to fight tax fraud, tax evasion and the informal economy, and this conclusion was also given in the country's Progress Report in 2016¹⁵. The latest situation is described in the country's Progress Report for 2018¹⁶, with particular criticism that the country did not follow the recommendations given since 2016, and the obligation for improvement of the tax system's capacity at central and local level through development, establishment and application of tax strategy in order to enable a modern tax service for the citizens still remains. Additionally, the general conclusion regarding financial and budget provisions (Chapter 33) was that the country should continue to harmonize its legal framework and to strengthen the administrative capacity with particular attention, inter alia, on taxation and statistics, due to the fact that data from this area are hardly accessible.

"The Law on VAT should be further harmonized with the EU law due to the fact that in the very first years of the Law implementation we had a European model of value added tax, but with all the amendments we made some steps backward. As a result, especially when it comes to VAT taxation of individuals, according the EU VAT Directives, it is necessary to incorporate the definition of the term "economic activity" in the Law that will eliminate all possibilities for potential manipulations and in order to create legal certainty for the taxpayers. In this regard, the Law on VAT of Croatia is a good legal text that we can take as an example in the process of adoption of new legislation". - Elena Neshovska Kjoseva, Assistant Professor at the Faculty of Law "Iustinianus Primus" – Skopje, interviewed on 12.7.2018.

14 European Commission. The former Yugoslav Republic of Macedonia – [Progress report 2015](#)

15 European Commission. The former Yugoslav Republic of Macedonia – [Progress report 2016](#)

16 European Commission. The former Yugoslav Republic of Macedonia – [Progress report 2018](#)

4.4 Individuals as VAT taxpayers

The Law on VAT does not make distinction between individuals or legal entities regarding their obligation to be registered as taxpayers for VAT purposes. On the contrary, VAT taxpayer is every person who permanently or periodically **independently** conducts an **economic activity**, regardless of the goals and the results of that activity (article 9, paragraph 1). The Law defines the meaning of the terms **economic and independent activity**. Thus, the economic activity shall be any activity by producers, traders and persons supplying services, including mining, agriculture and forestry activities, as well as exploitation of tangible or intangible property for the purposes of obtaining income (article 9, paragraph 2). The independent economic activity is defined by the “negative definition”, i.e. by enumerating which activities are not treated as independent economic activities for VAT purposes. Therefore, the following independent economic activities are not treated as an economic activity for VAT purposes: 1. Physical persons that are individually or in association employed in an enterprise and receive salary and are obligated to follow the employer’s instruction, and 2. Offices, subsidiaries or other separate units of an enterprise (article 9, paragraph 3).

This provision, with no precise criteria for interpretation, is too broad and allows extensive interpretations. Individuals can perform various types of activity, some of them are undoubtedly of commercial nature and as such are subject to VAT (for example consulting, lawyer, IT, audit, accountancy, etc.), but for some activities is particularly arguable and should be evaluated on a case-by-case basis (scientific and artistic activity, copyright contracts activities where the user is not defined, activities conducted once, membership in administrative and supervisory bodies, etc.). In absence of clear legal norms, it is quite possible to conduct broad interpretation of this provision.

“When we have imprecise Law or when we do not have Guidelines for implementation on certain provisions, the tax authorities can interpret it arbitrarily. This means that the Public Revenue Office will have to interpret some provision, but will not have any guideline how to resolve the situation”. – Professor of Economics, interviewed on 25.6.2018.

Thus, in January 2018, the PRO announced¹⁷ that individuals who perform economic activity taxable for the purposes of VAT, and in 2017 had total turnover over MKD 1,000,000, had to register as taxpayers for VAT purposes no later than January 15, 2018. It was explained that the total amount

17 Public Revenue Office, brochure, [Registration and VAT taxation of individuals](#), 2018.

of the VAT turnover includes the incomes derived from the performance of economic activity, such as the activities of expert witnesses and bankruptcy trustees, income from agricultural activity, income generated on the basis of temporary service contract, income from property and property rights, income from copyrights and industrial property rights, income from membership in supervisory boards, etc.

“This broad definition of the terms caused the problem when in January this year the Public Revenue Office requested all individuals who generated income on the basis of temporary service contract, income from copyrights and industrial property rights, etc., to register as taxpayers for VAT purposes, without making any Law changes”. - Professor of Economics, interviewed on 25.6.2018.

Such PRO's announcement, caused serious reactions, arising number of dilemmas and questions in respect to the definitions given in the Law, its compliance with other laws of the area, the legal consequences that occurred or would happen in practice, as well as the public view of this announcement as an attempt of the PRO to expand the scope of taxpayers silently. The biggest dilemma that has been imposed is the implementation of the announcement in terms of its legal ground, as well as the existence or non-existence of transparent, clear and available rules and procedures in the VAT tax system. Public concerns were going from justification for establishing such obligation, to the possible de-motivation for the prosperity of certain activities, as well as the emergence and development of different methods that citizens would eventually use to avoid this obligation, that would lead to tax evasion and an informal economy, which in Macedonia is already estimated as very high, between 20%-40% of GDP¹⁸.

VAT interpretation that all individuals who earn an income in total amount that exceeds the amount of the VAT turnover, despite of the source of that income (other than salary), the nature of the activity they perform, the continuity of the activity and whether the final consumer can be easily personalized, is assessed as an example of violation of the rule of law¹⁹. This very broad legal definition, that enables extended interpretation, has been a subject of very comprehensive analyzes by the civil sector in two occasions. The imprecise legal definition of the term independent economic activity of individuals for VAT purposes; lack of clear instructions on VAT deduction; failure to respect the principle of autonomy in terms of generating the in-

18 Strategy for formalization of the informal economy in the Republic of Macedonia, 2018-2022.

19 Finance Think, CEA. [Rule of law and the Economy: the Case of the VAT in Republic of Macedonia](#), Policy brief, No.26.

come, are some of the problems identified by the civil sector²⁰. Furthermore, there are serious challenges in the application of VAT regarding to the copy-right contracts²¹.

Whether and how much this provision is applied in practice is difficult to determine because the statistics published on the PRO website do not allow the distinction of VAT taxpayers as legal or natural persons.

4.5 Civil society organizations and the VAT

Civil society organizations²² are affected by the VAT in different way depending on their status, as consumers of goods and services or as performs of economic activity.

4.5.1 Civil society organizations as consumers of goods and services

Civil society organizations are obliged to pay the VAT, as consumers of goods and services crucial for their work and fulfillment of their responsibilities as VAT taxpayers (whether they are legal entities or individuals). This obligation has primarily financial implications by increasing the organization's expenditures. However, taking into account the activities of the civil society organizations, there are certain VAT tax exemptions given for the civil society organizations as consumers of goods and services.

Article 24-a, paragraph 1 of the Law on VAT states that direct tax exemption on the turnover of goods and services and the imports of goods for the implementation of projects (in most cases implemented by a civil society organization) financed with funds obtained by a contract for donation concluded between the Republic of Macedonia and foreign donors, is applied if the contract stipulates that the taxes will not be paid with the obtained funds. This tax exemption is also applicable to funds provided by the Budget of the Republic of Macedonia, but only for projects funded under the Instrument for Pre-Accession Assistance (IPA), implemented in conditions of decentralized management, when these funds are used for national co-financing of these projects (article 24-a, paragraph 2). In order to achieve this tax ex-

20 Ibid.

21 Petreski, M., Nikolov M., Garvanlieva V & Smilevski B. [Individuals in the VAT system and the rule of law – Special review and draft solution regarding the copyright contracts](#). 2018.

22 Registered according the Law on associations and foundations.

emption, there is a legal procedure²³ which in practice can be complicated or postponed²⁴ because it is necessary for the civil society organization to have the competent staff that can implement this procedure. Small organizations are particularly affected by this procedure and face certain problems and difficulties in obtaining this VAT tax exemption. According to the Report on the enabling environment for civil society in Macedonia for 2017, 57% of CSOs that responded to the questionnaire pointed out that they were mainly financed by foreign donors (exempt from VAT), 38% of the organizations used this tax exemption²⁵, and almost half CSOs (45%) believed that administrative procedures are not appropriate for the organizations` functioning, since the rules are too complex.

“...most of the individuals who earn income in amount that exceeds 1.000.000 denars, perform activities that are VAT tax exempted (projects from foreign donors). The state de facto could tax only the individuals who realize VAT turnover that is not covered with the exemption, but not the persons who work for civil society organizations for purposes of the foreign donors` project . My opinion is that these individuals should be exempted because they could never declare and pay the VAT. They are all people from the nongovernmental sector and the consulting business, who work on EU projects implemented in Macedonia..... Thus, most of the individuals who will receive income in amount more than 1 million denars from consulting activities de facto will not pay the VAT to the State, as they will not declare the VAT”. - Zharko Hadzi Zafirov, a lawyer from Skopje, interviewed on 4.7.2018.

The Law on VAT does not prescribe tax exemption for the other turnover, which the organizations realize from other sources (donations, domestic funds, national or local budget), and the VAT is paid.

23 The procedure is regulated by the Statute for the method and procedure for obtaining the VAT tax exemption for implementation of projects financed with funds obtained by a contract for donation concluded between the Republic of Macedonia and foreign donors, if the contract stipulates that the taxes will not be paid with the obtained funds, Official Gazette of RM, No. 90, from 30.6.2014.

24 Ognenovska S & Trajkovska S, [Report on the enabling environment for civil society in Macedonia](#), Macedonian Center for International Cooperation, 2018.

25 Ibid.

4.5.2 Civil society organizations as performers of economic activities

Civil society organizations can perform profitable activities²⁶. If the profitable activity that is performed realizes taxable turnover and if the amount of that turnover exceeds the amount of the required VAT turnover, than organizations are obligated to register for VAT purposes²⁷. However, in this case, due to the nature of the activity performed by civil society organizations which is in public interest, certain types of services provided for compensation are VAT exempted without the right to deduct and is not comprised by the turnover subject to taxation.

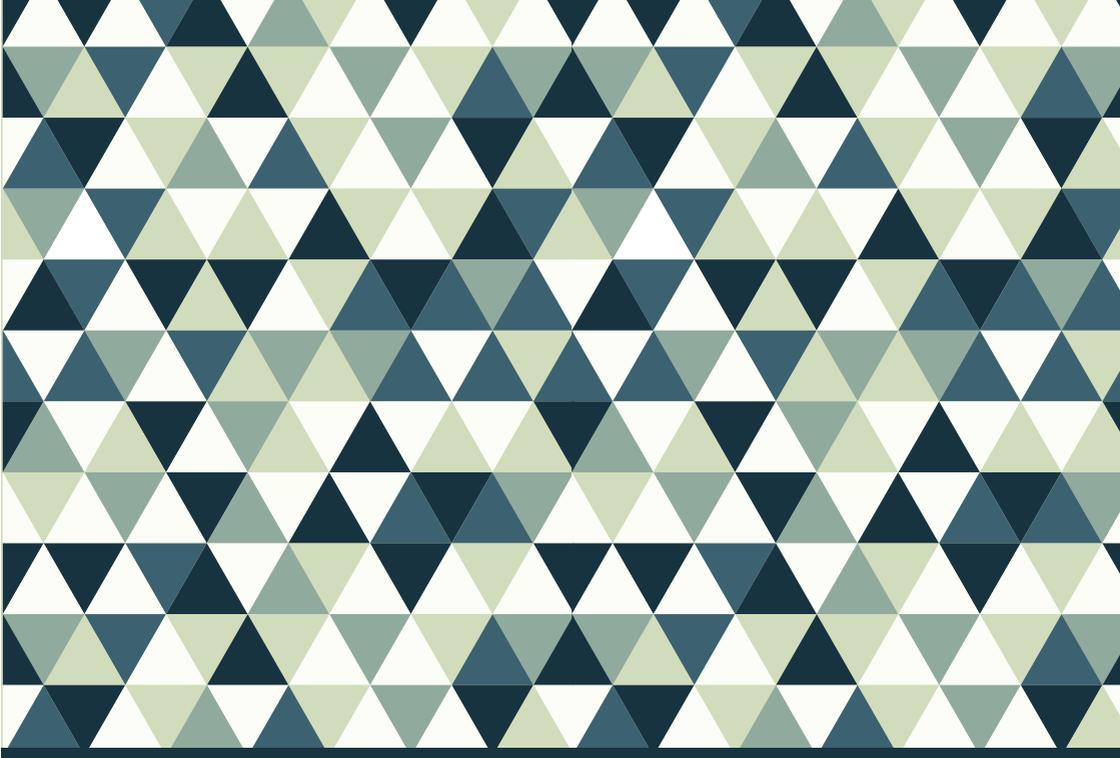
These services are as following (Law on VAT, article 23):

- “ 8. Turnover of institutions which are operating in the area of culture with non-profit cultural goods and services directly related to those services in accordance with the regulations in the field of culture and trade of botanical gardens, animal parks, parks, archives and documentation centers;
- 8-a) Tickets for public events that are of national interest in the area of the culture and which are recognized as such and financed through the Annual program for the realization of the national interest in culture for the year in which the public event is maintained by the Ministry of Culture;
- 11. Services and turnover of goods by institutions for social care and protection, as well as services to homes for hospitalization, care and treatment of the elderly people;
- 12. Services under the care and supervision of children and youth, as well as the trade of goods related to them;
- 13. Services within the placement of children and youth, and with them closely related trade of goods;
- 17. Educational services, such as: a) education and upbringing of children and youth, and b) services for professional training and re-training, as well as activities by centers and schools for learning foreign languages;”.

26 Article 48, Law on Associations and foundations, Official Gazette of RM, 52/2010 and its amendments.

27 Gacov, P. Jakjimovikj D., Murikj R., Nikolovska I., [Guideline for taxation of nongovernmental sector – procedures, rights and obligations](#), Pro - agens, Skopje, 2017.

If during the calendar year, the organization achieves the total turnover over 1.000.000 denars, is obliged to submit VAT registration application not later than 15th in the month following the month when the turnover is made. As registered taxpayers for VAT purposes, the civil society organizations will have obligation to declare VAT in the issued invoices, to pay the VAT to the State, to submit tax returns to the PRO through the e-tax system and have the right to deduct the previously paid tax. In other words, their registration as VAT taxpayers imposes the need for enhanced capacities for administrative and financial activities, but at the same time offers a possibility of deducting the previous tax.



5. IDENTIFICATION AND PROBLEM ANALYSIS

The comparative analysis of the EU standards, introduced in the **EU Directive 2006/112 / EC (the VAT Directive)** and in the tax systems of the countries from the region, showed that individuals are not separated from the VAT system. On the contrary, as performers of self-employed professions or in case of exploitation of tangible or intangible property, if their total income exceeds the VAT turnover for compulsory registration for VAT purposes, they become VAT taxpayers with all rights and obligations as well as legal entities. Therefore, individuals performing health, dental, veterinary, attorney, notary, consultancy, audit, engineering, architectural, journalistic, sports, cultural, translating or other intellectual activity undoubtedly perform activities and, as such, by exceeding the VAT turnover of 1 million denars, should become VAT taxpayers.

However, there are certain so-called border cases that require clear and precise legal framework that would determine whether or not the conditions for registration of individuals as VAT taxpayers are fulfilled. Such "border cases" were unfortunately also present in the previously mentioned PRO's announcement, which stated that all incomes from copyrights (whether there is a transfer or deviation of rights) and from membership in a supervisory boards were qualified as an economic activity.

From the conducted legal analysis, several key problems have been identified in relation to the legal framework that establishes the obligation for individuals to register as VAT taxpayers, which were confirmed in the conducted interviews and focus groups. There are four key issues regarding this issue:

- ① Lack of clear and precise legal provisions, that regulate who and when is obligated to register as VAT taxpayer.
- ② The reduction of the amount of the total VAT turnover for compulsory registration for VAT purposes is carried out without an adequate regulation impact assessment and it is unrealistically low.
- ③ The period of five calendar years in which VAT taxpayers remain registered regardless of the value of the total turnover is unrealistically long.
- ④ Lack of clear and precise provisions regarding the right to deduct the previous tax in cases when VAT taxpayers are individuals providing intellectual services.

5.1 Imprecise legal framework regarding the definition of the terms “taxpayer” and “economic activity”

There is lack of precise and clear provisions in the legal framework that regulate who and when is obliged to register as VAT taxpayers.

According the Law on VAT, a taxpayer is a person (physical or legal) who permanently or periodically independently conducts an economic activity, regardless of the goals and the results of that activity (article 9, paragraph 1). As a result, there are four essential characteristics of the VAT taxpayers, as follows:

- 5 Performance of economic activity,
- 6 Independence in the performance of the activity,
- 7 Permanence in the performance of the activity and
- 8 Generating income.

The Law on VAT partly defines only two of these characteristics, the terms “economic activity” and “independence”.

The economic activity shall be any activity by producers, traders and persons supplying services, including mining, agriculture and forestry activities, as well as exploitation of tangible and intangible property, for the purpose of obtaining income (article 9, paragraph 2).

“What is an economic activity? Taxi drivers, hairdressers, consultants, all of this is really an activity, here I am, because I am a professor of economics dealing with science, whether science is an economic activity, is culture a business activity, if someone draws a picture is that an economic activity? That’s not defined.” - Professor of Economics, interviewed on June 25, 2018.

This provision contains an internal contradiction which is not significant for proper application and law interpretation, but it is necessary to be emphasized from nomotechnical perspective. According article 9, paragraph 1, the goals and the results of the activity have no effect on whether a person will be or not a taxpayer. By contrast, in the next article, it is stressed that a key element of the term “economic activity” is the purpose of obtaining income.

“Economic activity requires a permanent and durable basis, but there are other factors that influence it. It is easiest with the supply of goods, but it is even more complicated with the supply of services. Hence, it is very important how the tax administration enforces the Law, because the law states that in order to be an economic activity, it should have an economic character, there should be payment in order to obtain income, to repeat the work, to be planned activity and organized So all the elements need to be taken into consideration, to be reflected in the situation and the particular case should be evaluated by the competent authority.” - from a conducted focus group with NGOs representatives.

Furthermore, the Law on VAT attempts to define what constitutes an “independent” performance of an activity by applying a “negative definition”, i.e. by enumerating what activities are not treated as independent economic activities for VAT purposes. Therefore, the following independent economic activities are not treated as an economic activity for VAT purposes: 1. Physical persons that are individually or in association employed in an enterprise and receive salary and are obligated to follow the employer’s instruction, and 2. Offices, subsidiaries or other separate units of an enterprise (article 9, paragraph 3).

“Scientific and artistic activity should fall under the legal definition according to the way the PRO interprets the provisions. What would be the difference between a consultant writing a law and an artist who makes a memorial? Both are contracted for temporary performance (that replaced the contract for work from the past). There is a big difference but from the aspect of the performers of the activity, because at the end someone will have to pay the VAT.” - Zharko Hadzi Zafirov, a lawyer from Skopje, interviewed on 4.7.2018.

The Law on VAT does not contain provisions relating to the permanence in performing the activity. Regarding the possibility to perform the activity temporally, the Law differs from the EU VAT Directive and the comparative VAT legislation. Also, the Law on VAT does not regulate the types of income that should be VAT taxable turnover. The Regulation for implementation of the Law on VAT does not include such provisions as well, different to the related Regulations of Serbia²⁸ and Croatia²⁹ that clearly and unambiguously contain definitions of these characteristics.

28 Ministry of finance of Republic of Serbia, Tax administration, [Guideline for implementation of the value added tax](#), Belgrade, 2010.

29 [Guideline on the value added tax](#), Official Gazette, 79/13, 85/13-corrections, 160/13, 35/14, 157/14, 130/15, 1/17, 41/17, 128/17)

"My recommendation is that, if the government wants this solution to be applied appropriately and not to open dilemmas in terms of the rule of law, it must additionally upgrade the Law on VAT, regarding the independence of the economic activity, the type of economic activity, its continuity and to specify the content of the VAT tax base. Secondly, the government's approach, that the tax evasion must be reduced, is correct, there is no dilemma here, but by clear and precise legal solutions that would guarantee the state of law." - Professor of Economics, interviewed on 25.6.2018.

5.2 Small amount of VAT turnover

The Law on amendments to the Law on VAT from 2014 decreased the amount of total VAT turnover from 2.000.000 to 1.000.000. According to the draft³⁰, this change was aimed to “expand the number of VAT taxpayers” that could “reduce the number of persons who do not declare and pay VAT, but perform economic activities which generate higher added value (supply of services)” and “increase the fair competition on the market”.

This reform was introduced without fulfilling the obligation for implementation of the regulation impact assessment established by the Rules of procedure of the Assembly of the Republic of Macedonia. In other words, there are no analyzes and explanations available for the public in addition to the arguments for reduction of the VAT turnover.

For comparison, the amount of total VAT turnover in Republic of Macedonia is the lowest among the region.

Comparison of the amount of VAT turnover in the region^{31,32}

Country:	VAT turnover:
Bulgaria	€ 25 565
Croatia	€ 40 324
Bosnia and Herzegovina	€ 25 600
Slovenia	€ 50 000
Montenegro	€ 18 000
Albania	€ 40 000
Kosovo	€ 30 000
Serbia	€ 67.100
Macedonia	€ 16.164

30 [Draft on Law on VAT](#)

31 [EU Commission VAT treshold 2018](#)

32 [Annacondia F. VAT Registration Thresholds in Europe. International VAT Monitor November/December 2017](#)

5.3 Long period of time in which taxpayers remain registered for VAT purposes

The period of five years in which the taxpayers remain registered for VAT purposes, regardless of the amount of the total turnover is unnecessary and unjustified burden on taxpayers who conduct business from a smaller scale on a temporary basis.

Taxpayers registered for VAT purposes remain registered at least five years, regardless of the value of the total turnover. Even in the fifth calendar year after the year of initial registration at earliest, if the total turnover does not exceed the amount of 1.000.000 denars, the taxpayers can submit an application for revocation of the registration for VAT (article 51, paragraph 7). Under some legally prescribed circumstances, the termination of the registration for VAT can be allowed before the expiration of the five calendar years. Thus, the registration can be permitted in the following two situations: when in the preceding calendar year the taxpayer **submitted tax returns without declaring the tax for the performed turnover and without expressing the deduction of the previous tax**, and when in the two previous calendar years the taxpayer submitted tax returns without declaring tax for the performed turnover, i.e. over the same period has no tax-free turnover with right of deduction, nor previous tax arising from the turnover of capital goods performed to the taxpayer or imported from him. In other cases, it is about termination of registration due to certain actions of the taxpayer by which the taxpayers are liable for penalty (article 51, paragraph 9).

During the period of VAT registration, the taxpayer is obligated, whether these is a obtained turnover or not, to submit monthly tax returns and periodical reports (article 41), causing additional burden and extra expenditures for accounting services for the individual who performs certain economic activity occasionally. This is a serious problem, especially if the taxpayer has stopped performing the economic activity soon after the VAT registration or if he has significantly reduced the scope of the activity. In any case, the obligation to submit a VAT return should be fulfilled within five calendar years.

“My personal opinion is that this is nonsense not only for physical but also for legal entities. For example, to start with legal entities - imagine you have a small company that exceeds the amount of one million and obtained 1.000.001... however, for 15 years it has realized a total turnover amounted to 500,000 denars ... As a result the entity will be registered for VAT purposes, the next year it will again obtain 500.000 turnover, but it will remain registered for VAT purposes for 5 years. The same example is applicable as well as for individuals, it will happen once one physical person to exceed the prescribed amount of total VAT turnover. I think this provision should be removed from the Law.” - Professor of Economics, interviewed on 25.6.2018.

Comparatively, the period after which the taxpayer can apply for termination of VAT registration due to reduced turnover below the prescribed one, in Republic of Macedonia is significantly longer than in the EU Member States and the countries of the region. Thus, this period in the United Kingdom is one year³³, in Croatia three years³⁴, in Slovenia two years³⁵, in Bulgaria two years for turnover in EU and one for internal trade³⁶. In the countries from the region that are non-EU countries, this deadline is also significantly shorter than the Macedonian. In Serbia it is one year³⁷, as well as in Montenegro³⁸ and Bosnia and Herzegovina³⁹, while in Kosovo the period is one year, while the termination cannot be made after the first year of registration⁴⁰. Obviously there is a tendency in the analyzed VAT systems the registration for VAT purposes to last one or two years. Republic of Macedonia drastically deviates from this trend.

33 [Value Added Tax Act 1994, Schedule 1](#)

34 Article 90, paragraph 3, Law on VAT

35 Art. 4 par. 4 [Value Added Tax Act](#)

36 Art. 108 Value Added Tax Act

37 Article 38a, Law on VAT.

38 Article 56, paragraph 1, Law on VAT.

39 Article 62, paragraph 1, Law on VAT.

40 Article 9 of the Law on VAT of Kosovo.

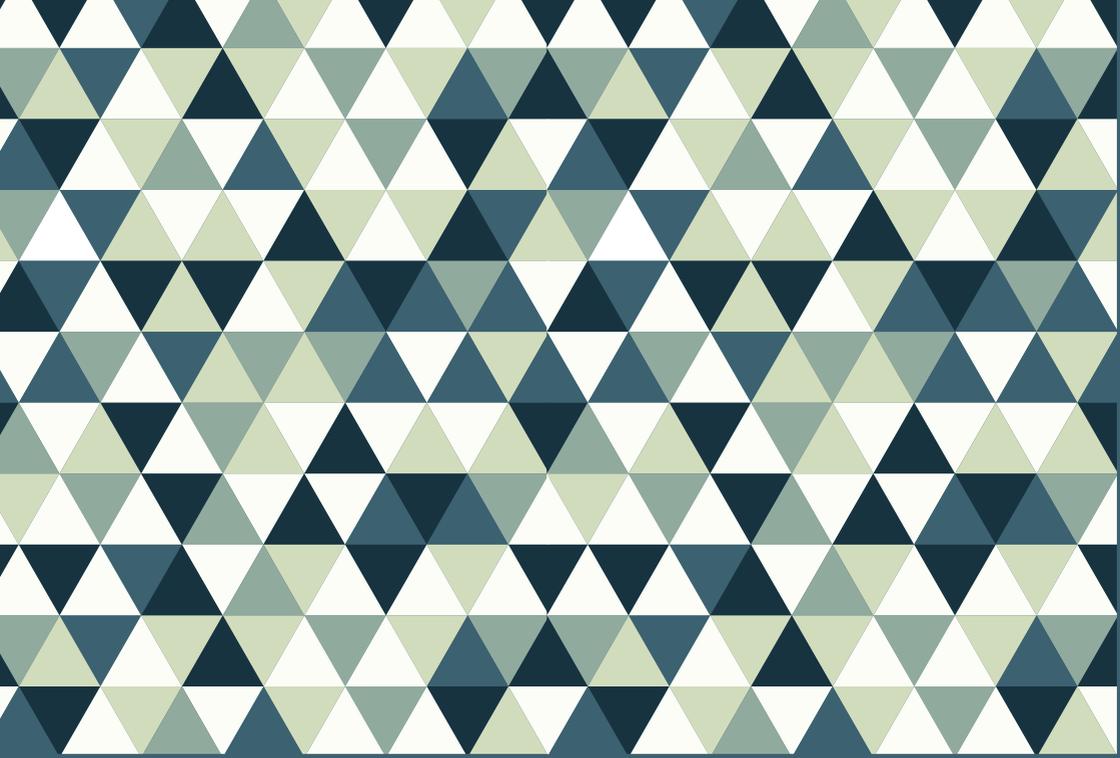
5.4 Lack of precise provisions regarding the right to deduct the previous tax

Due to specific characteristics of the activity of providing intellectual services by individuals, that significantly differs from production of good and supply of services by legal entities, there is a question about the right of the individuals, registered VAT taxpayers, to deduct the previously paid VAT. The VAT system that taxes the added value, with no right to VAT deductions, is not functional. The right to deduct refers to the amount that reduces the VAT for the performed turnover of a given tax period (Law on VAT, article 33). The right of VAT deduction arises at the moment when the following two conditions are cumulatively met (article 34):

- if the taxpayer uses the supplied or imported goods i.e. received services for the purposes of his economic activity;
- based on the invoice which is issued in accordance with articles 53 and 53-b of the Law on VAT or Customs Declaration in which is separately stated the paid tax for the import or the acts and reports from article 53, paragraph 2 of the Law on VAT and if such documents are evidenced in the accounting books of the taxpayer.

This provision arises the question, who and how will examine whether the purchased goods are used for the purpose of the taxpayer's economic activity in terms when the person provides exclusively intellectual services. Can the purchased computer or telephone and internet invoices be considered as such goods? Are travel costs, necessary for providing intellectual services, considered as goods that give the right to obtain VAT deduction when passenger vehicles are already excluded from the possibility of deduction (article 35).

"The right to deduct the previous paid VAT is attached with the performed activity. As a result, there is an additional problem if you are consultant who offers intellectual services, right? In order to perform the activity as good as possible, I need to straighten my intellect with food, vacation, right? Does this mean that I have the right to deduct the previously paid tax for every good purchased in Tinex or my vacation? And it is not regulated in the legal framework." - Professor of Economics, interview on 25.6.2018.



6. PUBLIC POLICY RECOMMENDATIONS

The analysis and the identified problems that arise in terms of VAT taxation of individuals confirm that there is definitely a need to undertake certain measures in order to strengthen the predictability of Law application regarding the individuals as VAT taxpayers. The European standards, established by the EU Directive 2006/112 / EC on the common system of value added tax and defined by the case law of the Court of Justice of the European Union, have been taken into account in formulating the measures we propose in this Document. In addition to the EU standards, certain comparative solutions have been identified that could be applicable in national context, and would contribute towards increasing the legal certainty of the individuals as VAT taxpayers.

It was of particular importance in defining the recommendations that they would not negatively affect the VAT vastness as a tax which contributes the most on the revenue part of the Budget of the Republic of Macedonia, as well as not to required substantial resources and costs for their implementation in practice. However, when formulating the recommendations, the basic and most important criterion is the need to guarantee the legal certainty and rule of law. Therefore, we propose the following recommendations:

Harmonization of the Law on VAT's provisions regarding the definition of the terms "taxpayer" and "economic activity" with the EU Directive 2006/112/EC (VAT Directive)

The harmonization with the EU VAT Directive regarding the term "**taxpayer**" would be achieved by amending article 9, paragraph 1 of the Law on VAT where the words "permanently or occasionally" would be abolished. The EU VAT Directive in defining this term does not include a time determination of the activity, but it presupposed continuity in performing the activity (Article 9 of the Directive). It is especially important to delete the word "occasionally" because it leaves space by doing one action, without the intention to perform an activity, a certain person to gain the status of VAT taxpayer. On the other hand, the word "permanently" should be amended in Article 9 paragraph 2 of the Law on VAT, where the economic activity is defined in the Directive's manner.

Harmonization of the Law on VAT's provision regarding the tax exemption, without the right for deduction of the input tax with the Directive 2006/112/EC of the EY (VAT Directive)

Article 132 of the EU VAT Directive contains a list of transactions that are tax exempted in the member states (including Republic of Macedonia as EU candidate country). The Macedonia Law on VAT incorporates some of these tax exemptions; although some of them are more restricted and others are not introduced at all. These activities are especially important for individuals and civil society organizations that perform activities in public interest. It is crucial to harmonize the tax exemptions established in article 23, point 11, 12, 13 and 17 of the Law on VAT with the tax exemption given in article 132 from the EU VAT Directive. Additionally, the following tax exemptions should be introduced in the Macedonian Law on VAT:

- the supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to cause distortion of competition (article 132, paragraph 1 (f));
- the supply of staff by religious or philosophical institutions for the purpose of the activities related to health and social protection of social vulnerable groups and children (article 132, paragraph 1 (k));
- the supply of services, and the supply of goods closely linked thereto, to their members in their common interest in return for a subscription fixed in accordance with their rules by non-profit-making organizations with aims of a political, trade-union, religious, patriotic, philosophical, philanthropic or civic nature, provided that this exemption is not likely to cause distortion of competition (article 132, paragraph 1 (l));
- the supply of certain services closely linked to sport or physical education by non-profit-making organizations to persons taking part in sport or physical education (article 132, paragraph 1 (m));
- the supply of transport services for sick or injured persons in vehicles specially designed for the purpose, by duly authorized bodies (article 132, paragraph 1 (p)).

Incorporation of provisions in the Regulation for implementation of the Law on VAT that will explain the Law's provisions regarding the terms "taxpayer" and "economic activity"

The Regulation for implementation of the Law on VAT should be amended by incorporating provisions that would explain the terms "taxpayers" and "economic activity", in order to facilitate the VAT application by the tax authorities and, on the other hand, to strengthen the predictability of the provisions regarding the individuals as potential VAT taxpayers. Unfortunately, the current Regulation does not contain any provision a propos this issue. Its amendments should be based on the best comparative practices from the region (Serbia and Croatia). The Regulation should be in line with the case law of the Court of Justice of the European Union and the Guidelines of the European Commission's VAT Committee concerning this matter. Also, it particularly should contain guidelines for implementation of following elements of the terms "taxpayer and economic activity":

- What is the meaning of "performance of economic activity"?
- When the economic activity is performed independently?
- How to determine the element of permanence?
- When is it considered that the activity is performed for the purpose of obtaining income?

Re-establishing the amount of total turnover for compulsory registration for VAT purposes from 1.000.000 to 2.000.000 denars

Republic of Macedonia has the lowest amount of total turnover required for compulsory VAT registration. This decrease was introduced without a mandatory regulation impact assessment and, as a result there are no adequate arguments why Republic of Macedonia should keep this amount of VAT turnover different to the countries from the region which have similar level of economic growth and living standard and have twice lower amount of total turnover for VAT registration. By increasing the VAT turnover, Republic of Macedonia would enable a better business environment for entrepreneurs and individuals as performers of economic activities to achieve a sufficient level of competitiveness to reach the VAT turnover of 2.000.000 denars and continue as VAT taxpayers.

Reduction of the period for compulsory registration as a VAT taxpayer from five to three years.

This is another characteristic of the Macedonian VAT system, which significantly differs from the countries in the region as well as from the EU Member States. The obligation for a five-year registration as a VAT taxpayer, regardless of the amount of total turnover and the size of the activity, creates other obligations and expenditures for the taxpayer (cost for accounting, etc.), but at the same time it uses the resources of the tax authorities in order to process the received VAT tax returns.

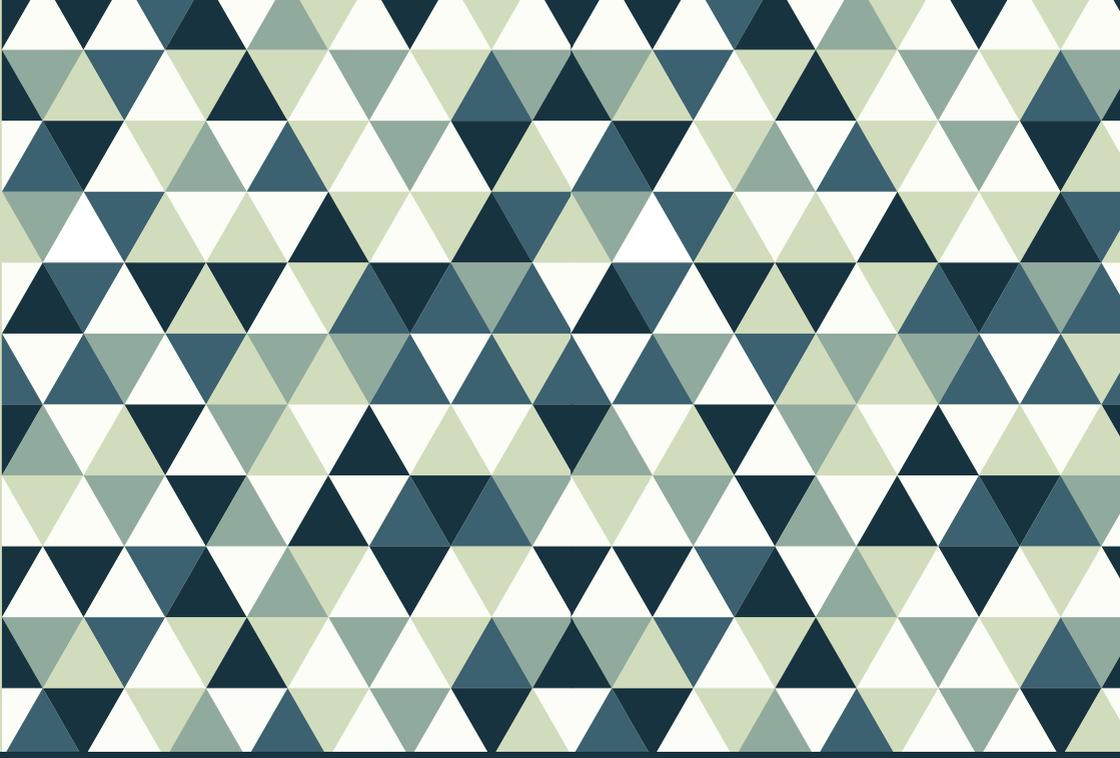
Compliance with the rules of the process of regulation impact assessment for adopting a qualitative, comprehensive and transparent legal solution

The RIA process identifies three stages: 1) strategic planning, 2) implementation of RIA, and 3) decision-making. In terms of strategic planning, we analyze the situation by the regulation, define the existing problems in the regulation, evaluate the impacts of economic, social, financial character and make environmental impact assessment. These conditions are published in the annual work program of the Government and the annual plan for implementation of the RIA, available for the public on SNER⁴¹. The implementation of the RIA as a second phase is probably the most important phase for the whole process, where the grounds for adoption of qualitative and legal solutions will arise. Common feature for most of the special activities of the second phase are the consultations with the stakeholders. They are an integral part of the RIA process and very important mechanism for increasing the quality of the regulation and improving the efficiency and effectiveness in implementing the projected measures⁴². The last phase is the decision-making phase, where the draft law and the draft RIA report are submitted to the General Secretariat of the Government of the Republic of Macedonia, the draft law is determined by the Government, and it is published along with the RIA report on the SNER. The key characteristic of this phase is implementation of the plan for monitoring and evaluation of the enacted law proposed in the planning process⁴³.

41 According to the Methodology for regulation impact assessment, point 2.1.

42 Ibid.

43 Ibid



7. FINAL CONCLUSIONS

The value added tax is the most important revenue in the Budget of the Republic of Macedonia, which generates almost half of the total tax revenues⁴⁴. Revenues from this tax are twice as high as revenues from excise and three times higher than revenues generated from the personal income tax and the profit tax. As a result, its collection and administration is of particular importance to public finances and tax authorities. Hence, the intention of the PRO stated in the announcement from January 2018 may be understood, regarding the broad appeal that all individuals who perform economic activity and their total turnover exceeds the amount of 1.000.000 denars have to be registered as VAT taxpayers. More taxpayers mean higher VAT revenues in the central budget. Although the most important goal in creating and implementing tax policies is collection of public finances, they also have a considerable role in terms of economic and social policies.

According to public reactions regarding the amendments to the Law on VAT which reduced the amount of total VAT turnover for compulsory registration and the actions of the tax authority in the last year, we can conclude that the regulation impact assessment on these changes was not conducted and imposed series of problems - subject of research and evaluation in this Document. Policies that are created should be in line with the basic principles of good governance: transparency and openness, effectiveness and efficiency; compliance and accountability, which are in fact the basic principles of the regulation impact assessment process and the scope of activities that it requires to be implemented.

It is indisputable that individuals can perform various types of activities in order to receive compensation, which are definitely from commercial nature (for example: consulting, lawyers, IT, auditing, accounting, production, translation, engineering, etc.). Comparative experiences and European standards are unanimous in the assessment that these persons, when exceeding the amount of total VAT turnover, should be registered as taxpayers for VAT purposes. Still, on the other hand, there are certain activities that are performed by individuals and do not fulfill the requirements to qualify as "economic activity", but as the broad manner of regulating in the Law on VAT and the lack of clarification of its provisions in by-laws, the tax authorities can qualify them as such (scientific and artistic activity for non-economic purposes, copyright agreements⁴⁵ in which the copyrights are not assigned or transferred, the activities in which the final consumer is not determined, activities that are performed only once, membership in administrative and executive boards, providing of social care services from physical persons, etc.).

44 Ministry of finance of Republic of Macedonia, [Citizen Budget 2017](#).

45 Petreski, M., Nikolov M., Garvanlieva V & Smilevski B. [Individuals in the VAT system and the rule of law – Special review and draft solution regarding the copyright contracts](#), 2018.

The extended interpretation of these provisions of the Law on VAT will have negative implications on the individuals. First of all, these persons would have obligation and costs for permanent keeping all accounting records and regular filing tax returns and reports for a period of five years, regardless of the amount of the turnover and the compensation they receive. Additionally, they would have to issue invoices and charge VAT to persons – consumers of their services that is especially inappropriate for members of the administrative and executive boards. VAT collection would increase the amount of the compensation for the service they provide, which could negatively affect the people in need for the service. It is quite reasonable to expect that physical persons in order to maintain the interest for their engagement will charge the same compensation fee and will pay the VAT from the total amount, and as a result the tax burden will be transferred to them, not to the final consumer, which is opposite to the purpose of the VAT. In this case, taking into account as well the obligation to pay personal income tax, the total tax burden of these individuals can reach 26.2%. Finally, the right to deduct the previous tax would be almost impossible to obtain due to the specifics of these activities, i.e. it is imprecise which goods and services would be treated as used for performing the activity.

Regarding the work of civil society organizations, the broad interpretation of these provisions would have limited effect. The price that civil society organizations are paying to the persons that would be registered as VAT taxpayers, would be increased for the VAT rate, but on the other hand, taking into account that the majority of the funds of these organizations come from foreign donors that are exempt from VAT, the burden would be irrelevant.

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