Aleksandra Maksimovska Stojkova[*]
Elena Neshovska Kjoseva[**]

MACEDONIAN TAX LEGISLATION COPING WITH THE EU INTEGRATION: REFORMING PROCESSES

Abstract……………………...………..…1
I. ***Introduction……………….………..…….2***
II. ***Harmonization of the Macedonian system of indirect taxation with the EU Tax Law….3***
III. ***Implementation of EU Directives into the Macedonian income tax legislation….……..3***
IV. Tax policy recommendations……….…..7

-Abstract-

Four years before the Macedonian authorities submitted the request for membership in the European Union, they have started the process of tax harmonization with the EU law. Therefore, in 2000 the legislator adopted the Law on the Value Added Tax that was completely established on the basic principles of the VI VAT directive, considered as the *raison d'etre* for VAT in every EU member states.

Different from the obligation to harmonize the national legislations with the EU rules in the area of indirect taxation, countries still preserve their tax sovereignty regarding the direct taxes. However, contemporary supranational tax problems and challenges, such as the issue of transfer pricing, aggressive tax planning, hybrid tax mismatches etc., require cross-border cooperation, mutual coordination and implementation of the measures adopted on EU level. In this context, most important is the EU Anti-Tax Avoidance Directive of 2016, which is a set of minimum standards and rules that aim to create a business environment with fair conditions for all EU members.

For this entire pre-accession period, the Republic of North Macedonia has undertaken series of reforms in the area of income taxes, although all the changes and amendments were or still are in direction of “relaxing” the tax policy. Since the current corporate tax system has not provided the much wanted and expected benefits, the country is still “suffering” from the significant tax revenue losses. It is the right moment to undertake serious steps toward reforming the Macedonian income tax legislation. These legal changes should be implemented regardless of the status of North Macedonia in the EU integration process, considering that vital interest of every country is to have sustainable and healthy public finances.

Key words: indirect taxes, tax harmonization, direct taxes, tax avoidance, corporate taxation.

[*] Full time Professor, PhD, University Ss. Cyril and Methodius – Skopje, Faculty of Law Iustinianus Primus, Department of Financial Law, bul. Goce Delcev 9b, 1000 Skopje, Republic of North Macedonia, a.maksimovska@pf.ukim.edu.mk
[**] Associate Professor, PhD, University Ss. Cyril and Methodius – Skopje, Faculty of Law Iustinianus Primus, Department of Financial Law, bul. Goce Delcev 9b, 1000 Skopje, Republic of North Macedonia, e.neshovska@pf.ukim.edu.mk

I. INTRODUCTION

The intensive process of globalization, performing cross-border business activities and the lack of mutual tax cooperation have put additional pressure on tax authorities to successfully detect and combat international schemes of avoiding tax liabilities. These actions cause tax base erosion that has its negative effect on the amount of collected tax revenues in the central budget and on the functioning of the global market.

In the last decade, the academia and the public have significantly increased their concern over the countries that have more favorable tax regimes (meaning low or no corporate tax rates, variety of tax incentives, etc). The worldwide problems, such as the growth of the budget deficit and the public debt, the violation of the principles of tax fairness and the revealed tax scandals Lux leaks and the Panama Papers, have drastically changed the perception of tax havens and abusive activities of taxpayers, especially multinational companies with a large network of permanent establishments worldwide. As a result, at the G-20 Summit in London, the political leaders announced their determination "to protect public finances and international tax rules from the threats that are coming from the non-cooperative authorities and to take concrete measures and actions against these countries".

In recent years, the global tax landscape has significantly transformed. Thus, while in the period 2003-2007, the main tax problem was the harmful tax competition, the tax evasion and the so-called aggressive tax planning were the key tax issues in the period 2017-2019 (Roland, 2018). These harmful tax practices were defined by the European Court of Human Rights for the first time as an "entirely artificial arrangement that does not reflect the true economic reality and it is undertaken by the taxpayer for one only purpose - to reduce the tax base (Maisuradze, 2016).

Profit shifting is an example of harmful tax practices, which is a widespread practice throughout the business world regardless of the size of the legal entity. Having in mind the activities that enable profit shifting, countries do not have sufficient capacities to unilaterally combat these destructive actions. Therefore, the world needs a coordinated international response. Throughout the years, the European Union has adopted and upgraded several legal documents that limit the scope of such activities. One of the main EU instruments in the efforts to fight against profit shifting is the Anti-Tax Avoidance Package. The Package encompasses the Anti Tax Avoidance Directive and four other elements: (1) a country-by-country report; (2) recommendations on the bilateral treaties for prevention of double taxation of income and capital and prevention of fiscal evasion; (3) external strategy, and (4) a study of aggressive tax planning (Neshovska Kjoseva, 2022).

The main purpose of this paper, which was presented at the Annual International Conference 2023 organized by the Faculty of Law "Iustinianus Primus" Skopje, is to summarize the level of harmonization of the Macedonian tax legislation with the EU tax law, with a special focus on the direct taxes, specifically on the corporate taxation. Additionally to the extensive and in-depth legal analysis of the tax reforms implemented in North Macedonia in the entire pre-accession period, the added value of the paper is given in the final remarks as tax policy recommendations for further changes in Macedonian legislation that should ensure and guarantee stable public finances that would enable state`s normal functioning, on one hand, and a higher quality of public services provided to all Macedonian taxpayers, on the other.

II. HARMONIZATION OF THE MACEDONIAN SYSTEM OF INDIRECT TAXATION WITH THE EU TAX LAW

Since declaring the country`s independence in 1993, Republic of North Macedonia has implemented various tax reforms that have gone hand-in-hand with the process of legal transplantation. In respect to indirect taxation, the state accepted the EU model of consumption tax. According to the country`s strong determination for EU integration, Macedonian legislator decided to introduce a consumption tax that will be in line with the EU tax law, on one hand, and compatible with value added taxes of the EU member states to facilitate the proper functioning of the single market and free movement of goods and services (Pendovska et al., 2017). In other words, Republic of North Macedonia faced additional pressure in "importing" indirect tax rules as a precondition for accession to the EU (Maksimovska Stojkova, et al., 2019).

Republic of North Macedonia introduced the EU VAT with tax credit method back in 2000, much earlier than required but as a symbol of the Macedonian motivation to join the European Union. Macedonian VAT was created as the one established by the 6th EU VAT Directive. For quit long period of time, North Macedonia had an European VAT model, although the Law has been amended more than 35 times in order to adapt the legal norms on the Macedonian socio-economic conditions and circumstances. One crucial amendment from 2014 that decreased the amount of total turnover for obligatory VAT registration has moved the country a few steps away from the EU VAT, but new law changes were introduced at the beginning of 2020 (amount of 2 million denars total turnover for obligatory VAT registration, and shorter period of 2 years for VAT registration) that brought the state back on the EU track. Yet, in the area of indirect taxation, we have successful transplantation where the benefits, given as a comparable type of consumption tax, are much bigger than handicaps. In this context, the Macedonian system of indirect taxes is very much in line and harmonized with the EU *acquis communautaire.*

III. IMPLEMENTATION OF EU DIRECTIVES INTO THE MACEDONIAN INCOME TAX LEGISLATION

Opposite to VAT and other indirect taxes, the situation is rather different in the area of income taxation. There is no harmonization and absence of directives since the EU has no jurisdiction over direct taxation. However, EU and OECD have implemented a few joint actions, especially in the area of international tax collaboration and the fight against tax evasion and tax avoidance. Soon after the OECD published the most common business practices that result in tax avoidance and tax evasion within the BEPS Action Plans in October 2015, the European Union reacted promptly to adopt appropriate anti-abusive tax measures. These measures aim to guarantee a uniform way of taxing the cross-border business activities of legal entities by eliminating the differences in national tax systems that cause legal loopholes that are later abused for tax avoidance and aggressive tax planning. Therefore, the European Commission on July 12, 2016, adopted the Directive on the prevention of tax avoidance with a primary goal to introduce anti-abusive tax rules that will be applied consistently within the Union.

1. The system of direct taxation in the European Union

On January 1, 2019, the Anti-Tax Avoidance entered into force for all EU Member States, drastically changing the way the Internal Market functions. The main purpose of the Directive is to neutralize the consequences of specific transactions and entities in the Internal market that were primarily undertaken to take advantage of the differences among national tax rules (Van Apeldoorn, 2018). The Directive includes five anti-abusive tax measures, whereas three rules derived from the OECD BEPS Project and two additional rules: Rule no.1 - interest limitation (Article 4), Rule no.2 - exit taxation (Article 5), Rule no.3 - general anti-abuse rule (Article 6), Rule no.4 - controlled foreign company (Article 7), and Rule no.5 – hybrid mismatches (Article 9).

(1) Article 4 of the Directive establishes the so-called *interest limitation rule*. According to this rule, the interest from a loan shall be considered as a tax-deductible expense, but only up to the amount of 30% of the taxable profit of the taxpayer. As a result, the taxpayer`s right to reduce the profit for taxation by the amount of net interest costs (so-called borrowing costs) shall be limited to a fixed ratio of 30% of the profit that is generated. Additionally, this anti-tax avoidance provision provides the Member States the following alternatives: (i) Member States may apply this fixed ratio to a group of taxpayers or may opt to apply a rule that compares the portion of capital and assets of every single entity to those hold by the group of taxpayers as related parties; (ii) Member States shall have the right to introduce a provision that would stipulate that this interest limitation rule would not be applied in following circumstances: (1) the borrowing costs, i.e. the financial expenses, do not exceed EUR 3 million; (2) in cases of independent entities that are not related parties, and (3) for projects of public interest, and finally (iii) the Member States may introduce a rule to carry forward the exceeding borrowing costs for a maximum of 5 years. Regarding financial institutions, there is a necessity for different approach due to the specific nature of their activities.

This rule is in line with the OECD recommendations regarding the most common practices that result in tax avoidance and profit shifting. Namely, many multinational companies coming from "high tax burden" jurisdictions enter into financial loan agreements to pay excessive interest to their subsidiaries situated in tax havens or low tax countries. As a result, the tax base is reduced in the country with high taxes, while it increases proportionally in the country with no or low corporate tax rates. Therefore, the rationale of this rule is to prevent such practices and to establish a minimum level of protection in the internal market.

(2) The exit taxation is regulated by Article 5 of the Directive. This *exit-taxation rule* was introduced as a means to prevent tax base erosion in the country of origin in a situation where taxpayers try to reduce their tax base by moving their headquarters or permanent establishments or by transferring their assets to no or low corporate tax rate countries. These harmful tax practices distort the internal market, erode the tax base in the country of origin and the assets or the business is transferred to Member States or third countries that provide more favorable tax treatment. All EU Member States were aware of these circumstances and, as a result, this rule did not cause major political discussions.

This rule stipulates that the taxpayer shall be subject to tax at the time when his assets or property are transferred to another Member State or a third state. According to this anti-abusive measure, the assets shall be taxed based on their market value at the time of the exit of the assets, in any of the following circumstances: transfer of assets, transfer of residency and transfer of a business activity from a Member State to another Member State or to a third country in so far as the Member State of the permanent establishment no longer has the right to tax the transferred assets due to the transfer. Market value is the amount for which an asset can be exchanged or mutual obligations can be settled between willing unrelated buyers and sellers in a direct transaction. On the other hand, transfer of assets means an operation whereby a Member State loses the right to tax the transferred assets, whilst the assets remain under the legal or economic ownership of the same taxpayer.

This rule shall not be applicable if the transferred assets are set to revert to the Member State within 12 months and to asset transfers related to the financing of securities, assets posted as collateral or where the asset transfer takes place to meet prudential capital requirements or for liquidity management. A Member State may also allow payment of this "exit" tax in installments over five years under certain circumstances prescribed by the Directive.

(3) Article 6 establishes a general anti-abuse rule aimed at preventing tax avoidance when this purpose was not achieved through the application of a specific anti-abusive tax rule. Moreover, this rule shall fill possible gaps that still leave room for tax avoidance. In terms of globalization, digitalization, openness and free movement of goods, services, capital and persons across the internal market, legal entities, especially multinational companies, quickly develop innovative schemes to avoid tax liability, while the national tax system cannot respond adequately. Therefore, there is a need for incorporation of general anti-abuse rule. According to this rule, to calculate the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law. This rule shall apply to arrangement or a series of arrangements that are not put into place for valid commercial reasons which reflect economic reality. In such circumstances, the Member State shall calculate the tax liability according to its domestic tax rules.

(4) As one of the ideas behind the Anti-Tax Avoidance Directive was the determination to prevent aggressive tax planning schemes where taxpayers shift significant amounts of profits from a parent company located in a high-tax country to their subsidiaries in a low-tax country, the attribution of income earned by subsidiaries in countries with low tax rates to their parent companies is regulated in Articles 7 and 8. According to these legal provisions, the parent company will be taxed in the resident country for the attributed income. Attributing the earned income to the parent company shall prevent its taxation in the tax jurisdiction with the lower tax rates.

Controlled foreign company means any entity established in the EU or elsewhere that is (1) controlled by a parent company resident in the EU and (2) subject of corporate taxation in an amount that is lower than the corporate tax that would have been charged if it was situated in the same tax jurisdiction as the parent company. This definition also covers the permanent establishment and requires legal and economic

control, although the control is de facto excluded. Moreover, a parent company is a company that holds direct or indirect participation of more than 50 percent of the voting rights; owns directly or indirectly more than 50 percent of capital or is entitled to receive more than 50 percent of the profits of the controlled foreign company. However, the directive does not take into account scenarios where the parent company has effective control over the subsidiary`s business decisions, but does not have a greater percentage of voting rights, capital or profits.

In order to determine the income that would be attributed to the parent company, Member States may use two approaches: (i) by providing a list of income based on legal classification (interest, royalties, dividends, copyright income and income from intellectual property, income from financial leasing and other financial activities, as well as income from the sale of goods and services that are geographically mobile and that represent the reason why the rules for controlled foreign company were adopted; and (ii) by prescribing that any income of the controlled foreign company that is generated as a result of an arrangement or series of arrangements which have been put in place for the essential purpose of obtaining a tax advantage shall be attributed to the parent company in proportion to its participation in the controlled company and shall be included in the tax period of the taxpayer in which the tax year of the entity ends.

(5) To deal with hybrid mismatches the Directive introduces an anti-abusive tax rule in Article 9. This rule is aimed to neutralize the negative effects that arise in case of undertaking hybrid legal acts to abuse the differences among national tax systems. Hybrid mismatches represent activities of tax planning that always involve two countries. Specifically, legal entities manage to take advantage of tax deductions in both countries or to deduct tax in one jurisdiction but without inclusion in the other Member State. In order to eliminate the negative effects, it is necessary to establish a rule according to which one of the Member States shall deny or shall not give the right to a tax deduction if the result is an abuse of regulations for tax purposes. According to Article 9 of the Directive, if the hybrid mismatches result in a double deduction, the deduction shall be given only in the Member State where such payment has its source. It is worth mentioning that this rule applies only to related parties and does not cover permanent establishments.

2. Transplantation of the Anti-Tax Avoidance Directive in the Macedonian Profit Tax on the Way to EU membership

Different from the high level of tax harmonization of Macedonian indirect taxes with the EU law, the tax system of North Macedonia does not contain many of the international and EU tax rules aimed at preventing tax evasion. Most likely, this situation is a result of the Government`s efforts in the last 15 years to create a business-friendly environment by promoting the country as the most tax-competitive compared to the countries from the region of Southeastern Europe. As a result, most of the amendments on the previous and current Law on Profit Tax refer to a decrease of the profit tax rate, an upgrade of the list of tax relief and tax exemptions with new ones, and changes in the expenses that represent tax-recognized expenses for tax purposes. Opposed to the attempts of OECD and the EU to undertake concrete measures and actions at a global level to deal with the activities of multinational companies that cause harm to national tax systems and

public finances, North Macedonia introduced only one anti-tax avoidance rule. Facing the pressure to harmonize the Macedonian legislation with the EU rules and to confirm the state`s commitments to be part of the global fight against harmful tax competition, tax evasion and tax avoidance, Law on Profit Tax from 2014 introduced a legal provision that regulates the tax treatment of interest between related parties (Maksimovska Stojkova, 2020).According to Article 13, an unrecognized expense for tax purposes is the amount of the part of interest on loans received from a related person, which exceeds the amount that would be realized if it were for unrelated persons. In the case of loans received from a related person, when determining interest expenses, the calculated interest is recognized at most up to the amount of the interest rate that would be realized between unrelated persons, at the time of loan approval. Contrary to the interest limitations prescribed by the Anti-Tax Avoidance Directive, the Macedonian legislation does not contain any limits. On the other hand, the definition of the term "related parties" is incorporated in Article 16, whereby the legally required percentage of participation in voting rights or in the right to distribute profits according to the Macedonian Law on Profit Tax is 25%.

IV. TAX POLICY RECOMMENDATIONS

During the entire EU pre-accession period, North Macedonia has implemented several corporate tax reforms that were/are mainly aimed at relaxing the tax policy. For almost 15 years, the country has been promoting the Macedonian tax system as business-friendly in order to increase economic development by attracting foreign direct investments. Therefore, the state`s corporate taxation system is featured with a low 10% corporate tax rate and a range of tax exemptions, such as non–taxation of reinvested profit, 10-years tax holiday in the free technological and industrial zones, donations in sports etc. Additionally, the Macedonian tax legislation has a few anti-tax avoidance rules.

As a result, North Macedonia is included in the EU`s list of non-cooperative jurisdictions for tax purposes. Despite the government`s efforts to intensify economic growth and development through tax policy measures, competent institutions still detect arrangements of profit shifting toward more favorable tax jurisdiction. Undoubtedly, the current corporate taxation system has not responded to the government`s commitments, and the country is continuously facing significant amounts of potential tax revenue losses.

Taxes are the main source for generating resources that enable the state`s normal functioning. For a long period, North Macedonia has managed to secure finances through borrowing, both externally and internally. However, the recent crises, such as the COVID-19 pandemic, the energy crisis, the war in Ukraine, the global inflation, have made additional pressure on the state to make tax law changes and amendments in order to increase tax revenues.

In order to overcome this situation and to improve the assessment of the country as "moderately prepared", Macedonian authorities have to undertake concrete activities to tackle and prevent future cases of tax evasion and tax avoidance by implementing the Anti-Tax Avoidance Directive into the Macedonian Law on Profit Tax and by amending the Law with the obligations that arise from the BEPS Inclusive Framework.

North Macedonia is still in a phase of rebuilding its corporate tax system in order to establish a system of corporate taxation that would guarantee equality and fairness in taxation. In such circumstances, companies, especially permanent establishments of large multinational enterprises, would give their fair share to society i.e. to the tax jurisdiction where they make a

profit from performing specific business activity. These changes in the Macedonian tax system should be undertaken, regardless of whether and when North Macedonia would start the negotiations for accession to the European Union. It is a vital interest of every country, EU Member State or not, to have a "healthy" and stable system of public finances.

Bibliography:

1. COUNCIL DIRECTIVE (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market
2. Maisuradze, Levan, *The Anti-Tax Avoidance Directive and its Compatibility with Primary EU Law*, Lund University, 2016.
3. Maksimovska Stojkova & Neshovska Kjoseva, *Assessment of the Situation in Republic of North Macedonia in Chapter 16: Reforms Implemented in the Field of Direct Taxation Since the Submission of the Application for EU Membership Until Today and Results,* Proceedings of Scientific Conference organized by the MANU, Ministry of Finance and the SEP, Skopje, p.231-243, 2023.
4. Maksimovska Stojkova, Aleksandra, *Controlled Foreign Company (CFC) Legislation, book chapter: CFC in North Macedonia*, Vienna University, Amsterdam, IBFD, 2020.
5. Maksimovska Stojkova & Neshovska Kjoseva, *Legal Transplants in Taxation: Benefits and Handicaps,* Proceedings of the 2019 Annual International Conference, "Transitions of Legal Systems: 30 Years after the fall of the Berlin Wall, Publisher: Faculty of Law "Iustinianus Primus"-Skopje, 2019.
6. McCarthy, Killian, Frederik van Doorn, Brigitte Unger, *Globalisation, Tax Competition and the Harmonisation of Corporate Tax Rates in Europe: A Case of Killing the Patient to Cure the Disease?*, Utrecht School of Economics, Tjalling C. Koopmans Research Institute, Discussion Paper Series 08-13, 2008.
7. Neshovska Kjoseva, Elena, *The Anti-Tax Avoidance Directive as a Mean to Tackle Harmful Tax Practices in the European Union - Legal and Tax Analysis of Its Rules*, Iustinianus Primus Law Review, Vol.13, Issue 1, Year 2022, Publisher: Law Faculty Iustinianus Primus Skopje, 2022.
8. Roland, Aanor. *European Corporate Tax Policy since the Crisis – How the EU steps up the Fight against Corporate Tax Avoidance*. Working Paper Series 'Comparative Govern-ance', No. 3, October 2018.
9. Seabrooke, L. and Wigan, D, *Powering ideas through expertise: professionals in global tax battles'*, Journal of European Public Policy 23(3), 2016.
10. Tofan, Mihaela, *Redesigning sovereignty using European and international tax avoidance regulation*, Jean Monnet Working Paper 17/20, NYU School of Law, New York, 2020.
11. Van Apeldoorn, Laurens, *BEPS, tax sovereignty and global justice*, Critical Review of International Social and Political Philosophy, 21:4, 2018, p. 478-499.
12. Pendovska, Maksimovska Stojkova, Zafiroski & Neshovska Kjoseva, *Tax Law*, University book, Publisher: Faculty of Law Iustinianus Primus – Skopje, ISBN 978-608-4655-87-9, pp.394, Skopje, 2021.
13. Pendovska, Maksimovska & Neshovska Kjoseva, *Value Added Tax in Republic of Macedonia versus European Model of Net Consumption VAT*, Journal on European Law, IRZ, German foundation for International Legal Collaboration, ISSN: 1875-842X, 2017.
14. Law on Value Added Tax, Official Gazette of RM, no. 44/99, 59/99, 86/99, 11/00, 93/00, 8/01, 21/03, 17/04, 19/04, 33/06, 45/06, 101/06, 114/07, 103/08, 114/09, 133/09, 95/10, 102/10, 24/11, 135/11, 155/12, 12/14, 112/14, 130/14, 15/15, 129/15, 225/15, 23/16, 189/16, 198/18, 98/19, 124/19, 275/19, 267/20, 163/21, 57/22 and 199/23.
15. Law on Profit Tax, Official Gazette of RM, no. 112/14, 129/15, 23/16, 190/16, 248/18, 232/19, 275/19, 290/20, 151/2021 and 199/23.