



Percentage tax designation

Country report: Macedonia

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ABOUT MACEDONIA

Republic of Macedonia is a landlocked country situated in the Balkan Peninsula. It used to be one of the Republics in Socialist Federative Republic of Yugoslavia. Upon the collapse of the federation, the country gained its independence in 1991. Macedonia has a population of 2.07 million¹, majority living in the urban areas. The GDP per capita in 2013 was 3.954 Euro while the average net salary of 356 Euro in 2015².

CIVIL SOCIETY ORGANISATIONS IN MACEDONIA

According to the data of the Central Registry of Republic of Macedonia, the total number of the registered Civil Society Organisations (CSOs) in the country in 2014 is 13.656. The Law on Associations and Foundations from 2010 required renewed registration. However, it did not regulate the status of the organisations that fail to renew their registration thus they remain in the official state registry. The number of CSOs registered according to the new law is 4.156. This registry also includes the sports associations which account for around 30% of the total number of re-registered organisations. According to available survey data, around 24,6% of the citizens are members of a CSO³.

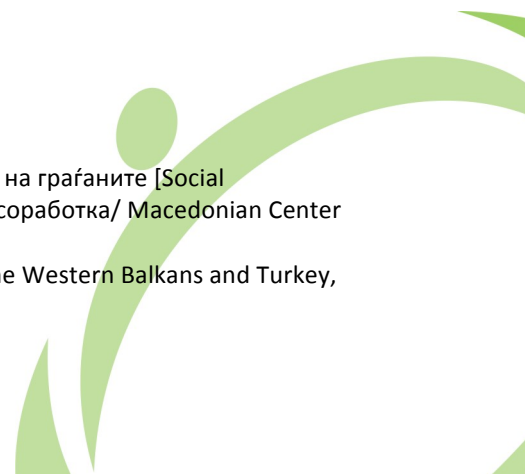
The CSOs in Macedonia are mostly small entities with modest economic value and financial capacity. The financial sustainability remains one of the biggest challenges for the sector. The total number of formally employed people in the sector is 1.897 thus majority of CSOs rely on volunteer work and project based professional engagements. Around third of the total number of CSOs (95% of those with renewed registration) have officially submitted their financial statements. From those, only 10% i.e. third of the re-registered organisations have submitted full financial reports⁴. Consequently, large majority of the CSOs have annual budgets below 2.500 EUR (the limit for obligatory financial reporting). According to the official data from the Central registry, the total revenue of the

¹ Official data of the State Statistical Office

² Ibid.

³ Клековски, С. и др. [Klekovski, S. et al.] (2011). Општествена одговорност на граѓаните [Social responsibility of the citizens]. Скопје. Македонски центар за меѓународна соработка/ Macedonian Center for International Cooperation.

⁴ Report on the economic value of the non-profit sector in the countries of the Western Balkans and Turkey, Balkan Civil Society Development Network, 2015



Macedonian associations and foundations in 2014 was around 81.523.383 EUR⁵. 68% of the revenues come from donations and grants regardless of the source (the non-profit accounting doesn't provide detailed information on the different sources of donors), 20% other income, and 12% income generated from economic activities (sales of products and sales of services, 6% each)⁶.

The state funding to CSOs is very low. In 2014 it amounted to around 2.317.050 EUR i.e. less than 3% of the overall revenues of the sector. According to a recent research, 11% of the CSOs have reported that state funding constituted over 10% of their annual revenues⁷. The system for financing of social services in public benefit provided by the CSOs is not developed and remains at small scale project funding, even though the laws provide legal basis for outsourcing mechanisms. Furthermore, with some exceptions, the allocation of public funds to CSOs lacks transparency and accountability and the institutions rarely follow the Code of good practice for financial support to associations of citizens and foundations. In 2015, only 10% of the public funding was allocated based on open call procedures⁸.

There is no official data on the citizens' and corporate contribution to CSOs. The official financial reporting formats for CSOs do not require separation of the different sources of grants and donations and they are reported in one bulk amount. The data available on the corporate giving also provides total levels of giving regardless of the recipient. According to the official information⁹ available, the total amount of corporate sponsorships in 2014 and 2015 is around 12 million EUR per year and has steady increase compared to the previous years¹⁰. Recent research commissioned by Konekt in 2014¹¹ showed that half of the companies have donated in the previous year, while 59% donated in the last three years. This is a consistent rate of corporate giving in the last decade. However, only 10% of the companies have donated to CSOs. At the same time there is a strong correlation between the giving and receiving a request for donation. In this regard, only around 23% of the companies received donation requests from CSOs (compared to 88% from individuals). It indicates passive approach by the CSOs in fundraising from local donors.

Tax incentives on private giving

To encourage private giving, in 2006 the Macedonian Parliament adopted a Law on donations and sponsorships in public activities. The law introduced tax incentives on the donations and

⁵ Ibid

⁶ Ibid

⁷ Огненовска, С. (2016) [Ognenovska, S], Извештај за овозможувачка околина за развој на граѓанското општество во Македонија 2015 [Report on the enabling environment for development of civil society in Macedonia 2015], Скопје, Macedonian Center for International Cooperation

⁸ Огненовска, С. (2016) [Ognenovska, S], Директно буџетско финансирање за граѓанските организации: основен преглед [Direct budget financing of the civil society organizations: general overview], Macedonian Center for International Cooperation, 2016

⁹ Information provided by the Central Registry of Macedonia

¹⁰ The financial formats in the previous years also included the donations in this expense item; however it was lately renamed only to sponsorships. This makes it difficult to assess whether these amounts include the donations as well.

¹¹ Карајков, Р [Karajkov, R], *Истражување на ставовите, верувањата и практиките за прибирање на ресурси и соработката помеѓу граѓанските организации и приватниот сектор* [Research on existing attitudes, believes and practices for local resource mobilisation and cooperation between the CSOs and the private sector], Association Konekt, 2015.

sponsorships provided by individual citizens and companies (as well as other legal entities). It didn't aim to regulate all forms of private giving but only those donations and sponsorships associated with certain tax benefits. The tax incentives provided by the law include:

- Personal income tax - tax credit system - decreases the amount of the personal income tax after the donation. The threshold of the tax incentive is twofold, 20% of the amount of the donor's annual personal income tax or maximum of 24.000 MKD (around 390 EUR).
- Profit tax - tax debit - decreases the tax base by allowing the donation/sponsorship to be accepted as eligible expenditure in amount of up to 5% from annual turnover for donations and 3% from annual turnover on sponsorships.
- VAT exemption on the goods and services supplied to the recipient for the purpose of implementing the public interest, either donated (in case of material donation) or paid from donated monetary funds.
- Property tax benefits which include exemption from the inheritance tax on donated immovable property and exemption from property tax on the ownership of donated property in the next five years.

The tax incentives apply to any form of donation (monetary funds, material goods and services and immovable property). The purpose and the subject of the donation or sponsorships have to be used exclusively for public interest purposes. The law is liberal in determining the beneficiaries and allows all not-for-profit legal entities (as well as other legal entities¹²) to receive tax-exempt donations and sponsorships.

Despite the good intentions of the law, there have been numerous challenges in its implementation. The law prescribes complicated administrative procedure in obtaining confirmation on the public interest for every single donation/sponsorship. In addition, the donor doesn't have the ex-ante information whether the donation they give is tax exempt. Such procedure created burden and legal uncertainty for the users, in particular the individual donors and the small and medium sized enterprises (SMEs). Consequently, in 2013 only 0,02% of submitted personal income tax forms claimed tax incentives on donations¹³. In the same year, 468 mostly large companies i.e. 0,66% of the legal entities used the tax incentives¹⁴. Almost half of the surveyed large companies and 1/3 of the surveyed medium-size companies used the tax incentives. Konekt's research¹⁵ confirmed the low level of awareness about the law. Approximately 1/4th of the enterprises were familiar with the Law regardless of whether they use tax benefits after donation or not. About 1/3rd believe that the Law has a positive impact on corporate philanthropy in Macedonia. Around 1/3rd don't have an opinion, and about 1/3rd believes that the Law has no positive effect.

PERCENTAGE TAX DESIGNATION AS A POTENTIAL OPTION IN MACEDONIA

¹² Tax exempt giving from company to company is not allowed by the law.

¹³ Смилевски, Б [Smilevski, B], *Анализа на трошоци и придобивки од даночните поттикнувања во законот за донации и спонзорства во јавните дејности* [Cost-benefit analysis on the tax incentives in the Law on donations and sponsorships in the public activities], Association Konekt, 2015

¹⁴ Ibid

¹⁵ Карајков, Р [Karajkov, R], *Истражување на ставовите, верувањата и практиките за прибирање на ресурси и соработката помеѓу граѓанските организации и приватниот сектор* [Research on existing attitudes, believes and practices for local resource mobilisation and cooperation between the CSOs and the private sector], Association Konekt, 2015.

Inspired by the tax designation mechanism introduced in some of the Central and Eastern European (CEE) countries, few CSOs and experts explored the possibilities of introducing the mechanism in Macedonia as well. The main discourse of discussion was how to provide more diversified and independent source of funding for the civil society organisations which would support the financial sustainability of the sector. In 2001/2002, First Children's Embassy in the World "Megjashi", supported by 48 CSOs initiated amendments in the tax laws. Among the amendments they proposed introducing 1% tax designation from the personal income tax to beneficiaries registered under the Law on Associations of citizens and foundations that serve the public interest (formally to be announced by the Ministry of Finance). The initiative was not endorsed by the Government with explanation that it would lead to significant tax expense for the state budget and significant revenue to the CSO which would be difficult to control. Later, in 2004, two eminent tax experts Slavko Lazovski and Borche Smilevski produced policy paper on sources for financial sustainability of the civil society organisations in Republic of Macedonia. In this document they explored the tax designation mechanism as one of the available options for state financing of the CSOs. Outlining the benefits and challenges of the 1% designation, they concluded that compared to the experience in the other countries introducing the mechanism would provide only small contribution in financing the CSOs and could not substitute the other forms of public and private financing. Their recommendation at the time was that the efforts should be focused on improving the legal and tax framework for CSOs including introducing tax benefits on the philanthropic giving.

After more than twelve years since the initial discussions, taking into consideration the changes in the legal and tax framework and the existing context, it is suitable time to revisit the percentage tax designation mechanism. The latest assessment of the impact of the percentage tax designation in the countries with such mechanism provides good basis to explore the potential in Macedonia. As in the previous analysis, in this paper the mechanism is explored mainly as one of the sources of funding for the CSOs. It does not explore the option for other beneficiaries to be included even though it is largely the case in the CEE countries that have percentage tax designation¹⁶. In this regard, the potential of the Percentage Tax Designation mechanism needs to be explored from two aspects: a) financial and administrative effects and b) potential benefits beyond finances.

Financial and administrative effects. Taking into consideration the existing structure of CSOs financing which is mostly based on project, restricted funding, it can be concluded that the percentage tax designation would provide additional source of more flexible funding for the CSOs. The individual CSO could use the revenues from this source for initiatives and costs that the foreign donors are not interested to support. Some of the initial concerns when introducing the mechanism was that the personal income tax base in Macedonia is small thus would provide modest level of funding. To roughly calculate the financial value we can use the average trends in the CEE countries with the mechanism. In the five countries with the percentage mechanism (Hungary, Slovakia, Poland, Lithuania and Romania) around 42,5% of the taxpayers use the mechanism. In Macedonia, the total number of taxpayers is not available since only the individuals with additional income (besides their salary/pension) are obliged to report on the personal income tax. Thus, for the simplified calculation purposes we can assume that the tax payers proportionally contribute in the total personal income tax revenue i.e. that 42,5% of the taxpayers would translate in 42,5% of the

¹⁶ For more information refer to Assessment of the Impact of the Percentage Tax Designations: Past, Present, Future, Edited by Boris Strečanský and Marianna Török, Erste Stiftung and Centrum Pre Filantropiu, 2016

annual personal income tax revenue. The personal income tax revenues collected in 2014 was 12.321 million denars or around 200 million EUR. 1% would amount to 2.000.000 EUR in total available to be used through the percentage mechanism. If we assume that 42,5% were actually used, the estimated revenue from the percentage tax designation would be 850.000 EUR which represents 1,04% of the total revenue of the sector. The revenue from the percentage designation in proportion to the overall revenues in the CEE countries with the mechanism is around 2%. This indicates that indeed, the financial value from the percentage designation mechanism will be modest. Nevertheless, as the state funding at the moment constitutes less than 3% of the total revenues of the sector (including the sports clubs), the percentage designation revenue would reach around 1/3 of the existing levels of state funding to CSOs. Even though the absolute amounts seem quite modest, the size of the individual CSOs is also small i.e. majority have annual budgets of less than 2.500 EUR. Consequently, while the percentage tax designation might not bring significant financial value to the large organisations, it could be valuable source of funding for many smaller and medium-size organisations.

One of the concerns in introducing the mechanism is the administrative burden it would create relative to the financial benefits to the beneficiaries. As the tax administration has been modernized and the system of e-taxes introduced it can be expected that in few years the procedure would not create a significant burden. However, in the existing setting, the personal income tax statements are revised by the tax authorities around six to seven months after they have been submitted thus, the beneficiaries would have to plan their budgets and cash-flow accordingly to accommodate potential delays. Once the mechanism becomes mainstreamed it is expected that it would provide more predictable funding for the beneficiary CSOs. The experience from the countries with the percentage mechanism shows that over the time the administrative burden decreases significantly and becomes straightforward process. The lessons learned from the five countries can be valuable in designing the technical aspects of the potential implementation of the mechanism.

It can be argued that introducing the percentage designation on the profit tax for the companies might provide more significant funding base and would be easier for the tax authorities to administer. However, the profit tax revenues collected in the previous years are lower or in the best case equal to the levels of the total personal income tax revenue. Many companies do not report profits thus, would not be able to fully utilize this mechanism. Even though relatively small percentage of the total number of companies uses the tax incentives on the corporate giving, the large and medium-size companies increasingly use the law on donations and sponsorships in the public activities. The reported levels approved for tax debit on the sponsorships¹⁷ amount to almost half of reported levels sponsorships thus in absolute amounts they cannot be overlooked. It provides incentives even for the companies that do not report profits as it decreases the tax base. Furthermore, there might be a concern that introducing the percentage tax designation for companies would lead to abolishment of the tax incentives on the corporate giving (as was the case in Slovakia) and might lead to lower levels of corporate giving. In this regard, revising i.e. simplifying the administrative procedure for obtaining the tax incentives on the corporate giving might be the more appropriate first step. The potential effects of introducing the percentage mechanism for the companies require additional careful consideration and analysis.

¹⁷ The accurate official data on the donations could not be provided for the purpose of this analysis.

Determining the potential beneficiaries of the percentage tax designation mechanism is another important aspect to consider. The experience from the CEE countries shows that the mechanism doesn't equally benefit all CSOs. In Macedonia, some areas such as humanitarian aid, health, children in need etc. would clearly receive more support from the taxpayers than issues such as rule of law, human rights etc. Thus, it will require careful design of the mechanism. Another aspect that needs careful attention is whether the potential beneficiaries would be all registered associations and foundations or it would be limited to the Public Benefit Organisations (PBO). In the existing legal framework, the percentage tax designation could be considered as an opportunity to introduce additional tax benefits for the PBOs. Namely, the Law on associations and foundations from 2010 introduced the concept of PBO which would receive additional tax and customs benefits and would be required to comply with higher standards of transparency and accountability. However, to this day no specific tax benefits for the PBOs have been introduced and the mechanism has not been used (only 1 organisation out of 3 who applied has received the status). The percentage designation might be an option to consider. However, there are concerns among some CSOs that the PBO status will be granted to small number of CSOs and that the process might be politically influenced.

Benefits beyond finances. The assessment of the impact of the percentage tax designation in the five countries with the mechanism showed that there are numerous benefits of the mechanism beyond the financial value for the sector. Reflecting on the existing context, the analysis indicates that some of these benefits are relevant for Macedonia as well. The potential benefits might be summarized as follows:

- *Assist in raising awareness among the citizens about the CSOs and in developing habit to contribute to CSOs.* In general the awareness of the public about the civil society sector and engaging in the CSOs is rather low. Most of the individual giving is directed to citizens in need rather than CSOs. This preference is also reflected in the attitudes of the companies' owners and managers. Introducing the mechanism would promote support to the CSOs as partners to the citizens in addressing their interests and solving social challenges. By allocating portion of their taxes to particular organization/s they would develop practice to support CSOs which on the long-term could result into higher levels of donations and volunteering in CSOs.
- *Stimulate proactive approach by CSOs to reach out to constituencies.* Being predominantly funded by foreign donors, significant portion of the CSOs operate in closed circles and fail to reach out to their wider constituency base. Konekt's research showed that they rarely seek donations from the companies and similar approach applies to the citizens as potential donors (reflected in low level of revenues from individual giving). Having the percentage designation mechanism available will push the CSOs to be proactive in informing and engaging their constituencies to support them by designating percentage of their taxes. Konekt's experience showed similar effects in organisations that decided to fundraise from local sources (citizens and companies). It will also improve the way the CSO communicates about their work and the impact they have on the target groups.
- *Provides mechanism for decentralized decision-making in state funding to CSOs.* This aspect is of particular importance having in mind the lack of transparency and accountability in allocating the state support to CSOs. It will also increase the awareness among the citizens about the importance of public spending and their role in the process.

For the CSOs such decentralized approach will mean less bureaucracy and more flexibility in obtaining and using the state funding as well as minimizing the political interference in the process.

- *Simplified procedure for the taxpayers.* Percentage tax designation provides user-friendly mechanism for the taxpayer to decide how to allocate portion of their taxes at no additional cost. It doesn't require the taxpayer to actually transfer the funds (as in the case of donations) and for majority of the taxpayers it will be administered by their employer. At this point, the tax benefits on the philanthropic giving are hardly used by individuals thus there is no threat that the percentage designation will affect the existing tax benefits. In addition, it might unlock the potential of the tax incentives on the donations. If the mechanism is introduced with relatively simple procedure, it might be expected that it will encourage the authorities to simplify the administrative procedure for the tax benefits on the philanthropic giving.

CONCLUDING REMARKS

Based on the impact of the percentage tax designation in the five CEE countries and reflecting on the environment in which the Macedonian CSOs operate, it can be concluded that the mechanism could be beneficial in diversifying the revenue streams of the sector. While the absolute financial value for the sector might be modest, the percentage designation represents opportunity for the CSOs in the following aspects: a) decentralized public funding to CSOs available to larger pool of CSOs; b) flexible, less bureaucratic and somewhat more predictable source of funding; and c) builds the practice of citizens to contribute to CSOs. In particular, the mechanism can be explored as specific benefit for the PBOs.

Proposing the introduction of the percentage tax designation mechanism in Macedonia will require process of consultations initially within the civil society and then with the relevant institutions. Having in mind the previous experience and other pending revisions in the tax legislation and state funding for CSOs, introducing the mechanism will largely depend on the political will and momentum. Further analysis is needed, in particular related to the beneficiaries, taxpayers who can use the percentage designation (esp. regarding the companies) and ensuring appropriate level of transparency and accountability in using the funds. The experiences from the CEE countries provide valuable guidance that can assist in developing the details of the mechanism suitable to the needs of the sector and the capacity of the institutions.

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