

# Hunting the Shadows – Tax Evasion Dynamics in Macedonia

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## 1. Introduction

According to estimates in 2013 the European Union lost around 1 trillion EUR in public revenues annually due to tax evasion and fraud.<sup>1</sup> Given that EUs' GDP summed up to 12.7 trillion EUR in 2013, tax evasion and fraud represented 7.9% of its annual GDP.

As a middle-income country, which is still reforming its tax authority, tax system and related measures against tax evasion and fraud, one can reasonably assume that Macedonia should expect at least a similar rate to GDP of tax evasion and fraud (7.9%) or at least 700 mln. EUR on an annual basis.<sup>2</sup> On the one hand, it negatively affects the competitive position of the companies that pay their taxes vis-a-vis the ones that evade taxes. On the other hand, it affects all citizens, as it undermines the everyday functioning of public services, (like healthcare, education, security, infrastructure etc.), which otherwise would have had better quality and extent. Furthermore, lost income through tax evasion and fraud affects the most, exactly the most vulnerable groups in the society by having fewer resources for social protection and social benefits programs.

Tackling tax evasion and fraud, being just a part of the policies targeting hidden economic activities, is not just a way to increase government revenues, but also a way to increase the fairness of the tax system, and improve tax acceptance and trust among its citizens and businesses, promote human rights, and enable appropriate protection to the most vulnerable in the Macedonian society.

## 2. Tax policies and their effects on the hidden economy

To understand the dynamics of tax evasion one needs to explore the factors that create the incentives for this type of behavior. Schneider (2012) has identified that the major contributory factor to tax evasion is the increase in tax and social security burden. This relates not only to the amount paid (the tax rate) but also to the ease of, and difficulties involved in, paying such tax and social security contributions. Thus

### KEY POINTS

- Tax revenues from pension and disability, and healthcare contributions in Macedonia have increased recently despite the lowering of tax rates.
- According to the Public Revenue Office tax evasion and issuance of cash register receipts were the leading causes for reporting irregularities throughout the period 2006-2013.
- The hidden economy survey among businesses has shown that half of interviewed companies agree that the tax system is good and stimulating for the development of businesses.
- But less than half (46.7%) of citizens reported to always receive receipts when buying groceries.
- And 1/3 of businesses reported that 'manipulating VAT' and 'employing accounting tricks in order to pay lower taxes' happens in their sectors

<sup>1</sup> Francois, Lenoir, *EU losing 1 trillion euros a year to tax dodging*. Reuters (21.03.2013). Retrieved from: <http://www.reuters.com/article/2013/04/12/us-eu-tax-vanrompuy-idUSBRE93BOKC20130412>

<sup>2</sup> Calculated by taking 7.9% of Macedonia's GDP for 2013 which is estimated at 10.2 billion USD or 9.02 billion EUR.  
This project is funded

reductions in the undeclared economy can be achieved by simplifying compliance.<sup>3</sup> Low tax morality, established as a second major contributing factor by Schneider, is moreover a symptom of high social security contribution rates, which then conveys into creating incentives for hidden economic activities, especially for the most vulnerable groups

In the case of Macedonia, since 2006 the Government of Macedonia (GoM) adopted a long-term policy of progressive reductions in the social security contribution rates in order to ease the tax burden on citizens and businesses (see Table 1) and has decreased contributions from 32% in 2006 to 26.6% of the gross salary in 2014. Additionally the GoM introduced flat profit tax and flat personal tax, and reduced their rates to 10% in 2008.

Table 1 - Social Security Contributions 2006 - 2015

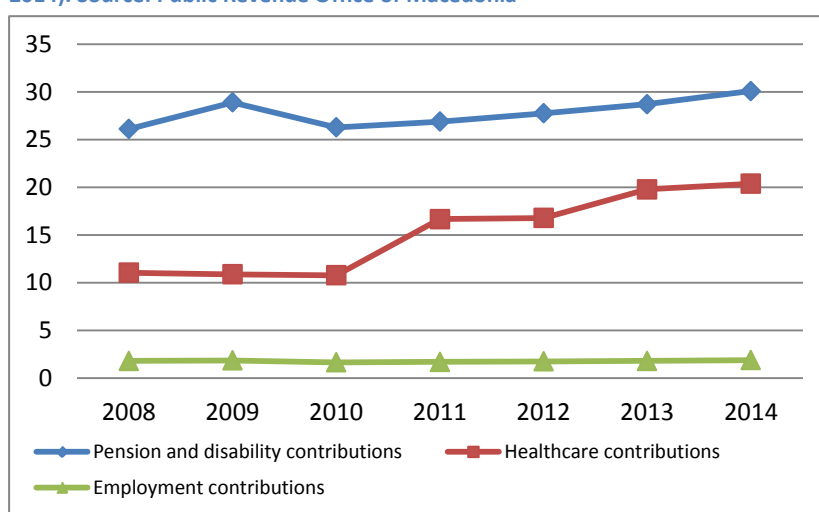
	2006	2007	2008	2009	2010/2013	2014	2015*
<b>Pension and disability contributions</b>	21,2	21,2	21,2	19%	18%	17,6%	17,5
<b>Health Insurance contributions</b>	9,2	9,2	9,2	7,5%	7,3%	7,3%	7,3%
<b>Unemployment Insurance Contributions</b>	1,6	1,6	1,6	1,4%	1,2%	1,2%	1,1%
<b>Additional Health Insurance contributions in case of accidents at work and work related injuries</b>				0,5%	0,5%	0,5%	0,5%
<b>Total</b>	<b>32%</b>	<b>32%</b>	<b>32%</b>	<b>28,4%</b>	<b>27,0%</b>	<b>26,6%</b>	<b>26,4%</b>

Source: KPMG (2012), the PRO (2014) and Trpeski, Tashevska (2012)  
<http://www.oeconomica.uab.ro/upload/lucrari/1420122/24.pdf>

This policy, according to Nenovski (2012)<sup>4</sup> resulted in improved tax ethics of the taxpayers, increased national budget, and reduction of the grey economy. Garvanlieva et al (2012) agree that the **reduction of the tax burden** leads to lowered incentives to avoid taxes and hence reduces the shadow economy.<sup>5</sup> It has to be noted that other studies, such as Mojsovska-Blazevski (2012), only partially support this claim.

Despite the lower personal income tax rate, the overall tax burden remained relatively high, in particular for low skilled labour, “caused by the minimum base for payment of social insurance contributions, which was prescribed at 65% of the national average wage rather than on the individual wage and at around 50% for health insurance on average (differentiated by branches, with higher relative burden on

Figure 1 - Tax revenues from social security contributions for the period (2008- Q3 2014). Source: Public Revenue Office of Macedonia



<sup>3</sup> Eurofound (2013), *Tackling undeclared work in Croatia and four EU candidate countries*, Eurofound, Dublin.

<sup>4</sup> Nenovski, Tome; (2012) “The Grey Economy in Macedonia: Macroeconomic Aspects, Implications and Possible Problem Solutions”, *Journal of Sustainable Development*, Vol. 5, Issue 10, March 2014. Retrieved from: <http://www.fbe.edu.mk/JoSDv10.pdf>, p. 12-13

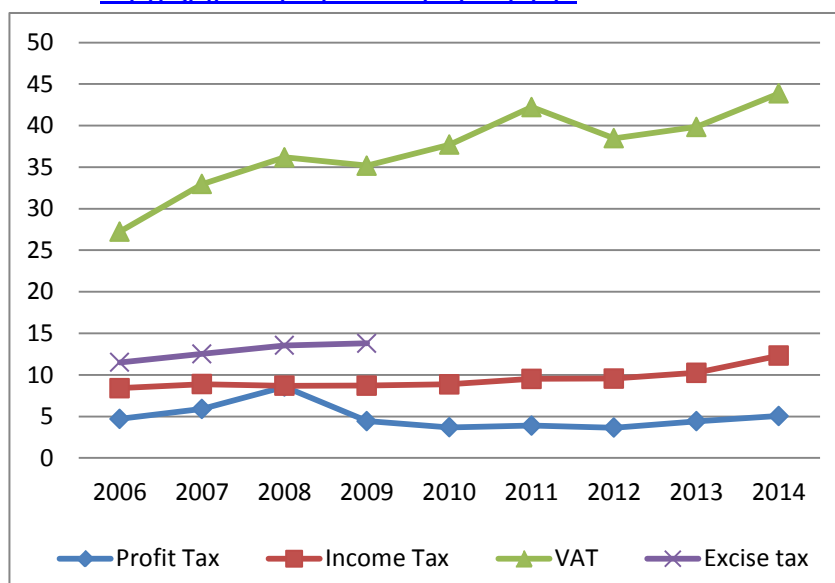
<sup>5</sup> Garvanlieva, V., Andonov, V., Nikolov, M. (2012) *Shadow Economy in Macedonia*. Skopje: Center for Economic Analyses

branches with lower average wages) (World Bank, 2008, p.11, Betcherman and Arandarenko 2008, Lopez-Murphy, 2008, Mojsoska-Blazevski et al., 2009, p.101)<sup>6</sup>

Looking at the statistical data coming from the Public Revenue Office (PRO), a **positive trend has been evident in tax revenues from pension and disability, and healthcare contributions**, especially since 2010 with an average annual increase of total contributions by 4.7%. At the end of Q3 of 2014 the percentage fulfillment of revenues compared to total revenues coming from social security contributions in 2013 stood at 69%. However, revenues from pension and disability contributions and employment contributions have not increased dramatically. In fact, throughout the 2008-2013 period, the revenues remain at average values of 27 billion MKD (440 mln. EUR) and 1.75 billion MKD (28.5 mln. EUR) respectively. The positive trend in total tax revenues from social security contributions stems solely from the rapid increase in revenues from healthcare contributions, which in 5 years has almost doubled from 11 billion MKD in 2008 to 20 billion MKD in 2013. This could be attributed as a positive effect from the consecutive amendments applied to the *Law on Mandatory and Social Security Contributions (LMSSC)*.<sup>7</sup> More research is needed in order to assess whether the additional tax income has resulted in increased expenditure on different public services such as healthcare, and maternity payments. However the budget of the Ministry of Health has doubled from almost 3 billion MKD in 2011 to 6 billion in 2014.<sup>8</sup> Additionally the expenditures of the Healthcare Fund for maternity leave have increased from 0.59 billion MKD in 2007 to 1.7 billion MKD in 2013.<sup>9</sup> However the absolute amount of the budget of the Healthcare Fund has averaged around 21 billion MKD<sup>10</sup> in the period of 2010-2013. This indicates that any increase or decrease of particular budget lines (such as the increase in maternity leave expenditures) is rather due to reallocation of budgetary resources from one line to another than to increases in overall tax revenues.

The data for collected tax revenue from the Public Revenue Service and the Customs (see Figure 2) in the period of 2006 – Q3 2014 shows that despite having introduced the flat rate system (10%) and different VAT exemptions that are less than the regular 18%, **revenues collected coming from personal income tax and VAT remain stable and show a positive trend**. However without further research it would be difficult to discern whether these positive

Figure 2 - Tax collection rates of the Public Revenue Office (In bln. MKD). Source: The PRO <http://ujp.gov.mk/mk/statistika/naplata/1/0/0>



<sup>6</sup> Trpeski P., Tashevska B. (2012) *Labour Tax Wedge in the Republic of Macedonia – Trends and International Comparison*. *Annales Universitatis Apulensis Series Oeconomica*, 14(2), 2012, p.575. Retrieved from: <http://www.oeconomica.uab.ro/upload/lucrari/1420122/24.pdf>

<sup>7</sup> Dzhekova, Franic, Mishkov, C. Williams (2014), "Tackling the Undeclared Economy in FYR Macedonia" GREY Working Paper No. 3, University of Sheffield. Retrieved from: [http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM\\_10072014.pdf](http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf) p.44

<sup>8</sup> Association for Emancipation, Solidarity and Equality of Women (2014). Retrieved from: <http://www.esem.org.mk/en/pdf/Publikacii/2014/%D0%90%D0%BD%D0%B0%D0%BB%D0%B8%D0%B7%D0%B0%202.pdf>

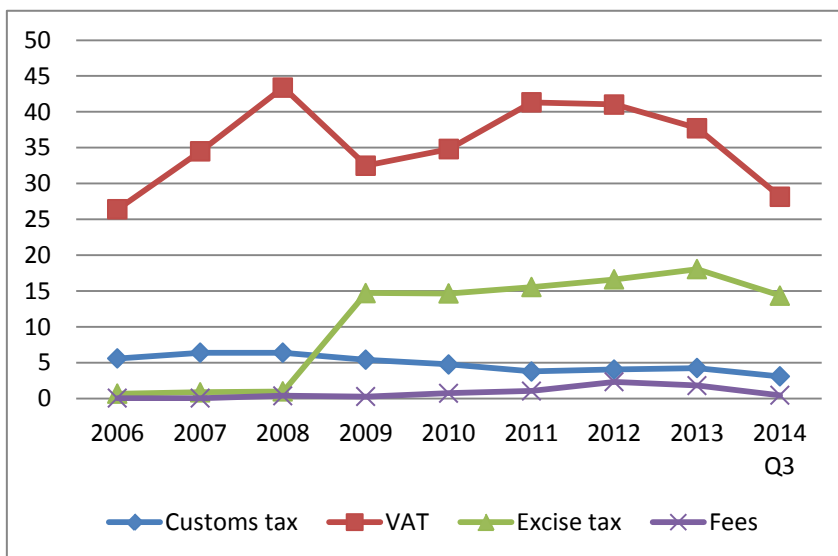
<sup>9</sup> Healthcare Fund of Macedonia, Annual Report 2013. Retrieved from: <http://www.fzo.org.mk/WBStorage/Files/Godisen%20Izvestaj%202013.pdf>

<sup>10</sup> Healthcare Fund of Macedonia, Annual Budget 2010-2013. Retrieved from: <http://www.fzo.org.mk/default.asp?ItemID=54D32B09ACC52C4D879570A45E3C307E>

trends are at large an indication of the presence of positive tendencies in terms of tax compliance and the ability of the institutions of Macedonia to enforce tax collection Or increased employment, consumption, imports etc.

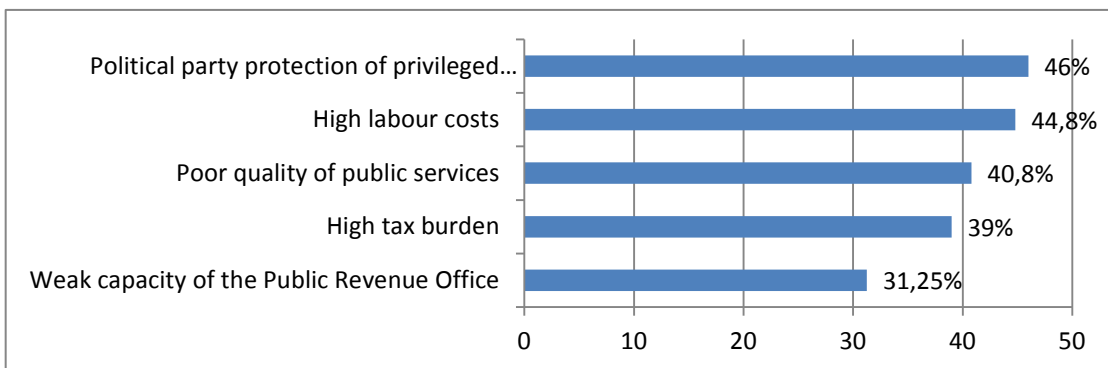
Similar situation is observed with the collection of excise taxes which have increased by 63% in the period 2006 – 2013. The gap in excise tax collection within the data provided by the PRO can be explained by the change in jurisdiction starting from 1<sup>st</sup> of January 2010 by which excise tax management was transferred from the PRO to the Customs Administration.<sup>11</sup> Despite the fact that they represent a smaller fraction of total tax revenues compared to the other types of taxes, tax revenues collected from profit tax, customs tax and customs fees, have stagnated with the start of the economic crisis.

Figure 3 - Tax collection rates of the Customs (In bln. MKD). Source: Customs Annual Reports: <http://www.carina.mk/DesktopDefault.aspx?tabindex=0&tabid=57>



Several researchers so far have attempted to better understand the impact of taxation policies on the tax morale and compliance of companies and citizens. The Center for Economic Analysis CEA (Stojkov et al., 2008) conducted a survey among companies in 2008, where the **perception on the introduction of the flat tax** was assessed. In general, it was perceived as a positive measure for the business climate, although there were wide variations among companies with regards to their size, sector and ownership structure. Particularly, the majority of companies (65%) stated that it had improved the liquidity of their company, and eased the calculation and reporting of the tax obligations for 78% of the companies. However, for most companies (61%) it had neither resulted in improved job creation nor created opportunities for new investments (for 57%).<sup>12</sup> Although one third believed that the flat tax policy model will initiate a significant improvement of the conditions for doing business in Macedonia, still, numerous factors for tax evasion have been mentioned, such as: excessive tax burden (most probably related to taxing procedures

Figure 4 – Factors of tax evasion according to businesses in Macedonia (in %)



Source: CEA, Stojkov, A.; Nikolov, M.; Smilevski, B., 2008, Flat Tax Policy Assesment in Macedonia

<sup>11</sup> European Commission (2010) *Commission Staff Working Document. The Former Yugoslav Republic of Macedonia, 2010 Progress Report*. [SEC(2010)1332]. Brussels: European Commission. P. 49. Retrieved from: [http://ec.europa.eu/enlargement/pdf/key\\_documents/2010/package/mk\\_rapport\\_2010\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2010/package/mk_rapport_2010_en.pdf)

<sup>12</sup> Stojkov, A.; Nikolov, M.; Smilevski, B., (2008) Flat Tax Policy Assessment in Macedonia, Center for Economic Analysis, Skopje

rather than tax rates), poor quality of public services, weak capacity of the Public Revenue Office, political party protection of privileged companies (patronage), and high labour costs (See Figure 4). With regards to the tax morale, 58% of respondents perceived the strengthened tax inspections as a cause of the improved tax revenue collection. This might imply though that when inspections are reduced and/or their effectiveness wears out, tax revenues might suffer. In addition, half of the companies recognized the simplified tax reporting and tax administration procedures as an important factor.

Mojsoska-Blazevski's (2011)<sup>13</sup>, research on the influence of labour legislation changes on the employment rate and the size of the informal economy showed a marginal effect of the flat tax policy. The author finds that **'the reduction of social security contributions had a positive impact on the employment rate, in contrast with the impact of the flat tax reform.'** She concludes that the social security and tax reforms aimed at reducing labour costs had the following positive effects: (a) helped employees during the crisis, (b) had an effect on employment, (c) increased the net wage, (d) diminished the extent of informal economy, (e) improved tax compliance, and (f) increased the number of individuals insured in the pension system.<sup>14</sup>

Ristovska, Mojsoska-Blazevski and Nikolov (2013) analysed data from the European Values Survey to determine the characteristics of Macedonian respondents with regards to issues related to tax morale, based on previous research on predictors of tax morale. The analysis showed that 81% of interviewed individuals in Macedonia reported that the "tax morale is never justifiable", finding no differences with regards to gender of respondents; but noting age differences, with the percent of people not justifying tax cheating increasing with age. In addition, full-time employees were strongly against tax cheating compared to the self-employed and the more educated were more strongly opposing compared to less educated. With regards to regional differences, the vast majority of respondents from the Southeast region reported highest tax morale, in contrast to respondents from the Polog and Southwest region. Importantly, respondents that stated high trust in the government and the judicial system reported higher tax morale compared to those who do not trust the civil service. Finally, the strongest opposition to tax cheating was 'found among individuals who are proud of their country and those with more pro-democratic belief'. While the results can be disputed as influenced by socially desirable responses, they nevertheless point to some **important elements of the tax morale, specifically the importance of trust in institutions and patriotic feelings.**<sup>15</sup>

The tax morale cannot exclusively be explained with the explored independent variables. The study shows that they explain about 28% of the variability of the tax morale, while additional unexplored factors may explain the rest. Another important finding is that results for Macedonia differ in some regards to those from studies for other European countries. Specifically, gender and marital status were not significantly related to tax morale in Macedonia, unlike in other countries. In addition, only **income, out of the socio-economic variables, was found to be related to tax morale**, but not the educational attainment and economic (labour market) status.<sup>16</sup>

### 3. Institutional Framework for combating Fraud and Tax Evasion.

<sup>13</sup> Dzhekova, Franic, Mishkov, C. Williams (2014), "Tackling the Undeclared Economy in FYR Macedonia" GREY Working Paper No. 3, University of Sheffield. Retrieved from: [http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM\\_10072014.pdf](http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf)

<sup>14</sup> Dzhekova, Franic, Mishkov, C. Williams (2014), "Tackling the Undeclared Economy in FYR Macedonia" GREY Working Paper No. 3, University of Sheffield. p.44-45. Retrieved from: [http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM\\_10072014.pdf](http://www.grey-project.group.shef.ac.uk/wp-content/uploads/2014/08/WP3-Tackling-the-Undeclared-Economy-in-FYROM_10072014.pdf)

<sup>15</sup> Ristovska, M., Mojsoska-Blazevski, N., Nikolov, M., (2013) An Alternative View to the Tax Evasion: The Effect of Tax Morale on Paying Taxes in Macedonia and EU Countries, Serbian Journal of Management 8 (2)

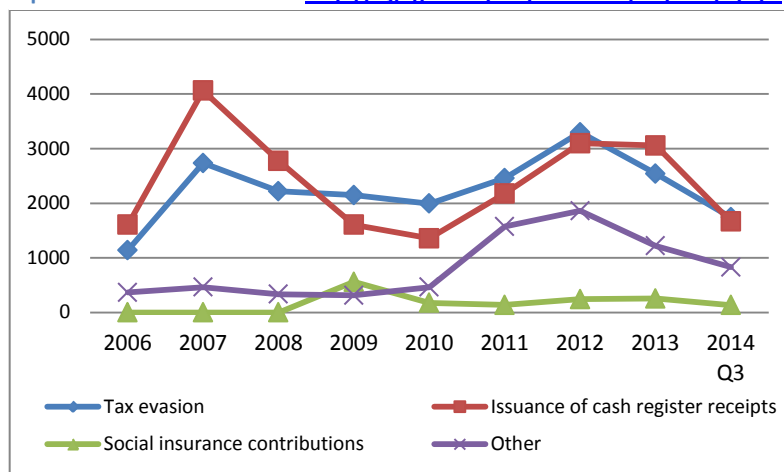
<sup>16</sup> Ibid.



### The Public Revenue Office (PRO)

The Public Revenue Office functions as part of the Ministry of Finance and is responsible for tax collection and other receivables. It is tasked with tackling tax evasion and fraud as well as other violations of the tax code through the General Tax Inspectorate (GTI), which performs tax audits. Looking at Table 2 in the period 2011-2013 can be observed that nearly half of the audits were protruded with irregularities with a slight decline in 2013 (6.806 audits), which is expected to continue by the end of Q4 2014.

Figure 5 - Reports of irregularities through the PRO's hot line (198) and E-report. Source: PRO statistics <http://ujp.gov.mk/mk/statistika/naplata/9/0/0>



By using the reports for irregularities submitted through the PRO's hot line and e-reports tool the types of violations can be diversified. **Tax evasion and issuance of cash register receipts were the leading causes for reporting irregularities throughout the period**

Table 2 - General Tax Inspectorate and its audit activity (2011 - 2014 Q3).

	Total audits conducted	Audits with irregularities detected	Ratio of irregularities detected/total audits performed
2011	7.771	3.522	45%
2012	7.292	3.698	51%
2013	6.806	3.171	47%
2014 Q3	4.942	1.951	39%

**2006-2013.** These two types of violations represented 78% of all reports in 2013.<sup>17</sup> By the end of 2014 a new measure on tackling the hidden economy is being implemented, which establishes a direct link of fiscal cash registers that gather transactions data in real time from the point-of-sale to the PRO, which in practice should enhance the investigative powers of the PRO and other interconnected agencies and registers. The real-time data flowing from the fiscal cash registers should enhance the PRO's targeting capabilities while at the same time decrease the amount of ineffective audits that do not detect irregularities.

Irregularities concerning social security contributions have amounted to the least amount of reports throughout the same period. The category 'Other' consists of violations concerning misconduct of a PRO's official and irregularities within the jurisdiction of other institutions which show a tendency to increase.

Additionally, in 2013 a Forensic Laboratory was setup within the PRO, which is responsible for tackling high-risk fraud.<sup>18</sup> The PRO also started a campaign of 'public shaming' by publishing a black list of unpaid debts, and late paying debtors on a monthly basis whose debts were above 120,000 MKD (2,000 EUR) for individuals and above 300,000 MKD (5,000 EUR) for legal entities.<sup>19</sup> Generally PRO's efforts are focused on decreasing business costs for compliance with the tax system by means of simplifying rules and regulations and in the process making tax authorities more efficient and effective.

### Financial Police (FP)

<sup>17</sup> The Public Revenue Office (PRO) statistics on audits and irregularities. Retrieved from: <http://ujp.gov.mk/mk/statistika/naplata/9/0/0>

<sup>18</sup> European Commission (2013) *Commission Staff Working Document. The Former Yugoslav Republic of Macedonia, 2013 Progress Report*. [SWD(2013) 413 final]. Brussels: European Commission. P. 34. Retrieved from: [http://ec.europa.eu/enlargement/pdf/key\\_documents/2013/package/mk\\_rapport\\_2013.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2013/package/mk_rapport_2013.pdf)

<sup>19</sup> Official Gazette of the Republic of Macedonia nr. 13/06...187/2013. Retrieved from: [http://www.ujp.gov.mk/files/attachment/0000/0587/Zakon\\_za\\_danocna\\_postapka\\_187\\_30.12.2013.pdf](http://www.ujp.gov.mk/files/attachment/0000/0587/Zakon_za_danocna_postapka_187_30.12.2013.pdf)

The Financial Police is responsible for uncovering financial criminal offences such as tax evasion and fraud,

Table 3 - Types of offences detected by the Financial Police. Source: Financial Police Reports <http://www.finpol.gov.mk/statistiki.html> and [www.mkbudget.org](http://www.mkbudget.org)

Types od offences	2006	2007	2008	2009	2010	2011	2012	2013	Total
Tax Evasion, Art. 279	47	16	47	67	41	46	23	48	403
Falsifying and destroying business record journal, Art. 280			37	62	38	24	21	35	217
Money laundering and other income from punishable acts, Art. 273	47	14	2		1	1	1		131
Abuse of position, Art. 353		11	5	8	18	11	7	8	69
Fraud, Art. 247	1	1	1	1	3	1	13	3	26
Damaging or unlawfully privileging creditors, Art. 257		1	2	1	5	1	2	4	16
Embezzlement in the service, Art. 354-353					2		14		16
Falsifying documents, Art. 378		1	1		3		3	2	12
Other	3	2	0	5	4	4	7	10	37
<b>Total</b>	<b>98</b>	<b>46</b>	<b>95</b>	<b>144</b>	<b>115</b>	<b>88</b>	<b>91</b>	<b>110</b>	<b>927</b>
<b>Total damages (Mln. MKD)</b>				668	708	569	1,241	662	3848

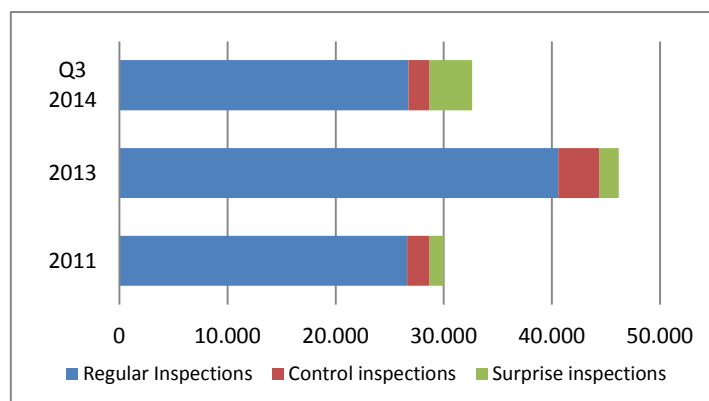
money laundering, smuggling, unlawful trade and other criminal offences that produce significant amount of unlawful income. The FP also takes part in joint inspections with the PRO and the State Market Inspectorate in order to detect and punish offences and acts of misdemeanor within their jurisdiction<sup>20</sup>. Accordingly, the FP is an important partner in the joint fight against hidden economic activities. The table below presents the types of offences and their occurrence through the period of 2006-2013.

It is apparent that the vast majority of the offences are focused within 2 misdemeanor categories, tax evasion (art. 279), and falsifying and destroying business record journal (art. 280)<sup>21</sup>. In fact, in 2013 these 2 categories represented 75% of all detected offences. In financial terms all 110 offences in 2013 have accounted for damages amounting to 662 mln. MKD (10.7 mln. EUR) which are significant compared to the FP's operational annual budget of around 30 mln. MKD (0.5 mln. EUR)<sup>22</sup>. However, due to lack of data concerning the collection rate of the detected damages, it would be difficult to estimate the effectiveness of the FP's operations and policy impact. In this respect it is advisable that the PRO starts reporting on the follow-ups of their investigation, the prosecuted crimes, and the final verdicts approved by court decisions. This will allow better performance management and allocation of scarce public resources.

### The State Market Inspectorate (SMI)

The **State Market Inspectorate** (or so called Market Surveillance Inspectorate) is an important stakeholder in tackling the hidden economy. As indicated in the 2014 Action Plan for the Fight against the Grey Economy in Macedonia, its responsibilities have been enhanced in terms of strengthening control over undeclared activities in the fields of catering, tourism, and at restricted places such as green markets, pavements, and

Figure 6 - Types and number of inspections performed (2011 - Q3 2014). Source: SMI annual reports



<sup>20</sup> Law on Financial Police, (Official Gazette of RM, 12/22.01.2014), Retrieved from:

<http://www.finpol.gov.mk/Files/Zakon/12.pdf>

<sup>21</sup> Penal Code Law, Consolidated Text (13.11.2012). Retrieved from: <http://www.finpol.gov.mk/Files/Zakon/8.pdf>

<sup>22</sup> <http://www.mkbudget.org/rashodi/details/ime/%D0%A3%D0%BF%D1%80%D0%B0%D0%B2%D0%B0%20%D0%B7%D0%B0%20%D1%84%D0%B8%D0%BD%D0%B0%D0%BD%D1%81%D0%B8%D1%81%D0%BA%D0%B0%20%D0%BF%D0%BE%D0%BB%D0%B8%D1%86%D0%B8%D1%98%D0%B0/godina/2013/vidrashod/9>

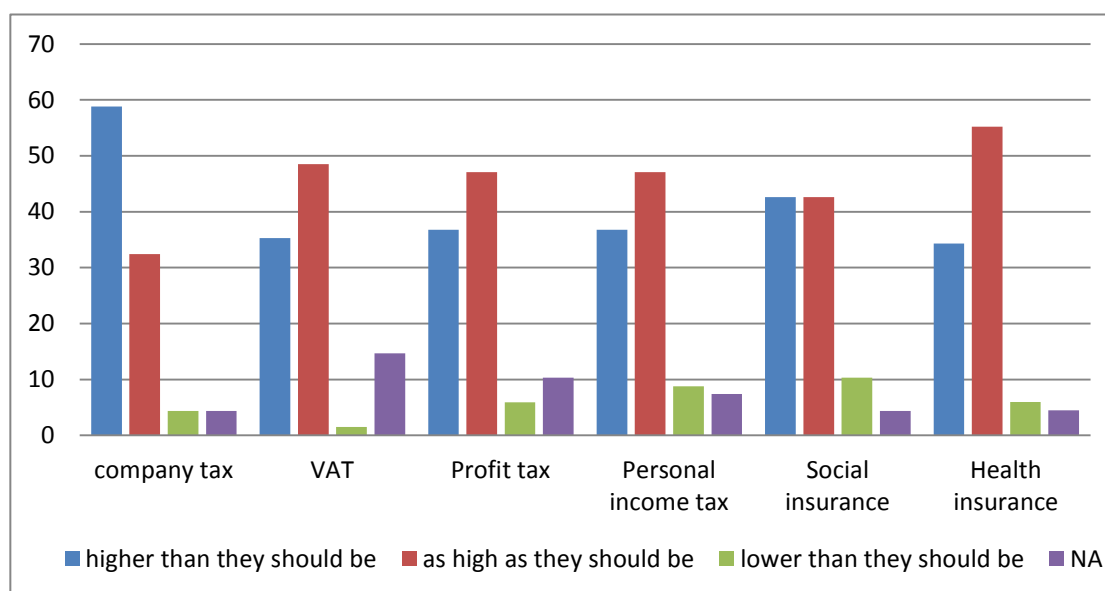
other public spaces. Strengthening control in relation over marketed products and consumer protection is also being enhanced. However, in 2013 out of 4.000 consumer complaints received by the SMI only 1.5% were addressed. In the first half of 2014 this figure has only slightly increased to 2% of addressed consumer complaints.<sup>23</sup> To address this deficiency the SMI was tasked to submit their reports to the Ministry of Economy on a monthly instead of quarterly basis as it was the case till recently.<sup>24</sup>

The total number of inspections carried out has increased from 26,599 in 2011 to 40,582 in 2013 (See Figure 6). A significant change can be observed within the structure of the performed inspections where in 2011 surprise checks consisted only 4%, in Q3 2014 they equated to 12% of all inspections. While inspections are needed to ensure compliance, in the case of SMI, which seems to deal with micro and small enterprises mostly, more effort should be put into positive motivation.

#### 4. Tax Evasion in Macedonia – Survey Data

Tax compliance is an immanent part of every business venture, but taxes often represent a burden for businesses and a reason to direct part of their actions into the informal sphere. This is why the opinion of businesses regarding tax policies is important for developing policies, which guarantee tax compliance.<sup>25</sup>

Figure 7 - How would you assess the size of different tax rates in Macedonia?



For the majority of businesses interviewed, the current tax system does not represent a problem for development of their business (42%) or represents an insignificant problem (23%), regardless of the size of the company. The largest detected problem is the unfair competition, assessed as a big problem by 67% of businesses, especially micro companies.

Half of interviewed businesses agreed that the tax system is good and stimulating for the development of businesses (17% agreed completely with this statement, while 33% agreed partially). On the other

<sup>23</sup> Independent.mk, "Consumer Protection Activities Intensified in Macedonia", 02.07.2014. Retrieved from: <http://www.independent.mk/articles/6746/Consumers+Protection+Activities+Intensified+in+Macedonia>

<sup>24</sup> It has to be noted that available data on the annual and quarterly activities of the SLI is limited, especially for the period 2006-2010, whereas the annual and quarterly reports for 2012 are missing altogether.

<sup>25</sup> This section contains data from the population and business surveys conducted in the framework of the project "Promoting Good Governance and Economic Rights through Empowering Macedonian Civil Society to Monitor and Tackle the Hidden Economy in Macedonia". The survey was conducted among representatives of 70 companies, nationally representative in terms of size and sector; during the month of October 2014. Data refer to the opinion of surveyed business representatives and citizens on the different issues related to taxes, tax morale and tax compliance; specific practices for paying and reporting taxes; etc



hand – 21.4% disagreed partially with the statement and 15.7% completely disagreed, which still shows high potency for hidden economic activities. There are no differences with regards to the company size.

With the notable exception of the company tax, and to some degree of social insurance, there seems to be agreement among the businesses concerning the size of different taxes. About half of interviewed business representatives considers the current amount/size of taxes to be appropriate, less than half of businesses reported that they are higher than they should be, and small number consider them to be lower than they should (Figure 7). Contrary to what is expected, micro firms were more accepting of the existing taxes and believed they are appropriate size/amount compared to the small/medium and large companies who were more prone to consider them to be higher than they should be. The latter seems to point to an important social role of SMEs who seem more intertwined with local social fabric. No doubt, the most interesting case is the one of social security contributions, which are considered by the highest share of companies both higher and lower than they should be in comparison to the other taxes (excluding company tax). Reforms in this domain will be very difficult and would entail the spending of considerable political and social capital for a long period of time. Hence, it is advisable that all political stakeholders in the country reach an agreement on the main elements of such reforms in advance.

Nevertheless, apart from the general satisfaction with the tax system in the country, **taxes are considered to play an important role in the occurrence of hidden economic activity**. Specifically, the ‘high tax burden’ is considered to be the third most important factor for the existence of hidden economy, selected by 39% of business representatives, after the ‘impulse of businessmen towards getting rich fast’ (45%) and ‘corruption’ (40.6%) (Figure 7). Consequently, the top three measures proposed for reducing hidden economy include – ‘introducing more effective stimulation for businesses’, selected by 58.6% of businesses; ‘reducing taxes’ (47%) and ‘reducing/tackling corruption’ (44.3%) (Figure 8).

Evidently, businesses are more inclined towards stimulus, rather than punitive measures, which is partially in contradiction with the main set of policies, which the Government of Macedonia is implementing in order to tackle the issue.

Figure 7 - Most important factors for the existence of hidden economy

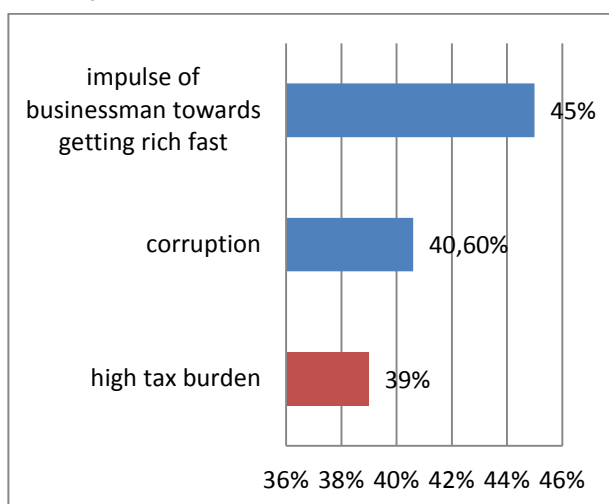
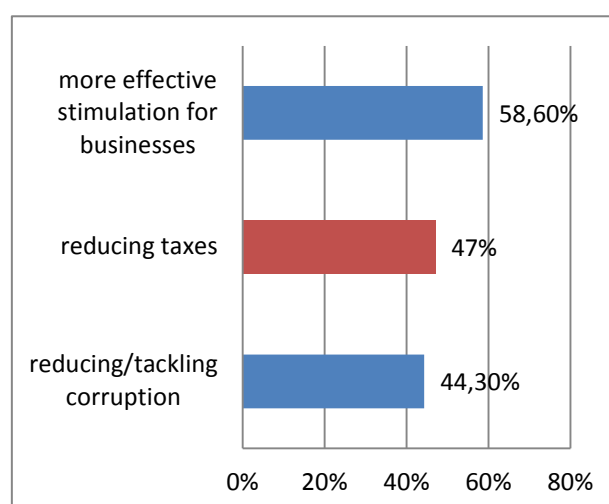


Figure 8 - Measures for reducing hidden economy



Source: Business survey of 70 companies, conducted during October 2014

Various methods of avoiding and/or manipulating tax reporting and compliance appear to occur within companies. Specifically, somewhat more than half of companies confirm that there is a practice of reporting smaller incomes than the real ones among companies from their sector, with 10.1% claiming it happens all the time, 14.5% in most of the cases and 29% sometimes (Figure 10). In line with this, approximately same distribution of responses go for reporting a lower turnover than the real one, with 5.9% of companies stating it happens all the time in their sector, 16.2-in most of the cases and 32.4%-sometimes (Figure 9).

Figure 9 - How frequently companies tend to report lower turnover than the real one

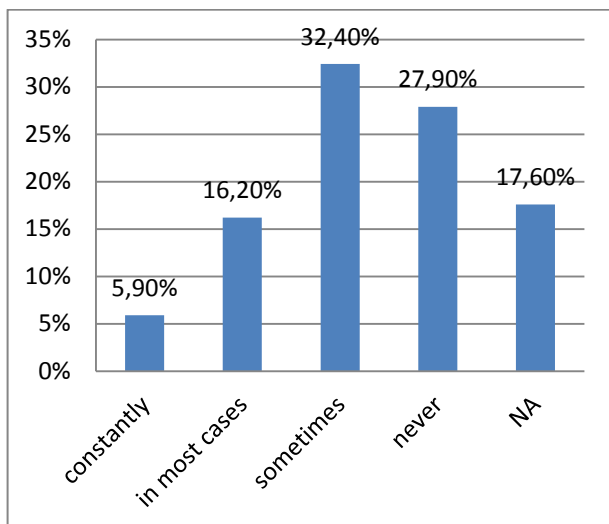
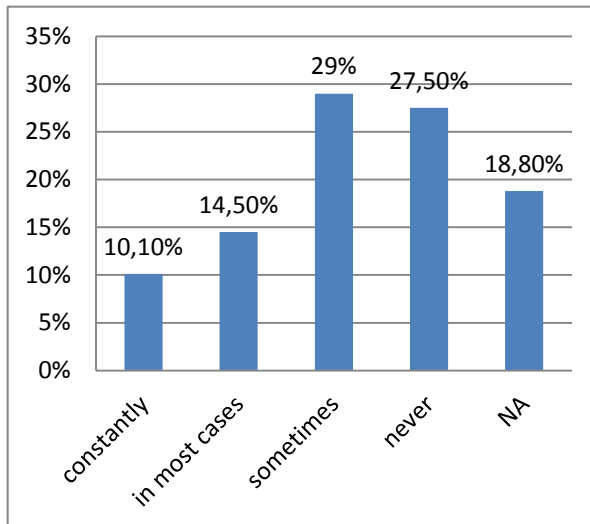


Figure 10 - How frequently companies tend to report smaller income than the real one?



The population survey provides relative confirmation to these findings, visible through the data on provision of fiscal receipts. Less than half (46.7%) of citizens reported to always receive receipts when buying groceries; only every third citizen reports to have always received receipts when buying clothes and shoes, alcohol and tobacco; and every fourth when buying books. Although cases of never receiving fiscal receipts are rare (reported by less than 10% of respondents), the tendency of businesses to hide part of the profit/turnover is nevertheless evident.

Figure 11 - Percentage of companies paying lower taxes than the required by using accounting tricks

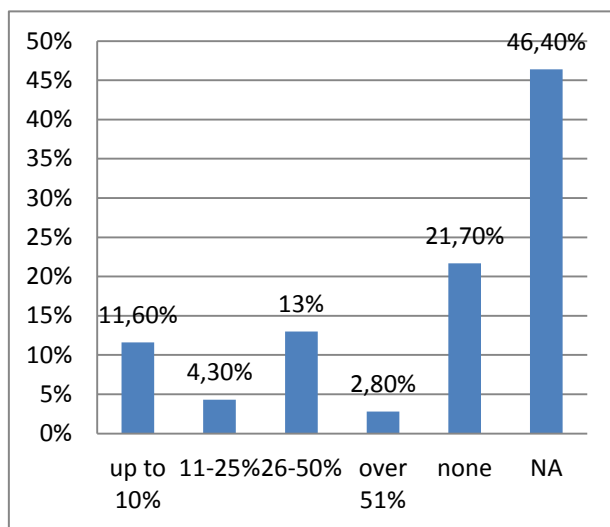
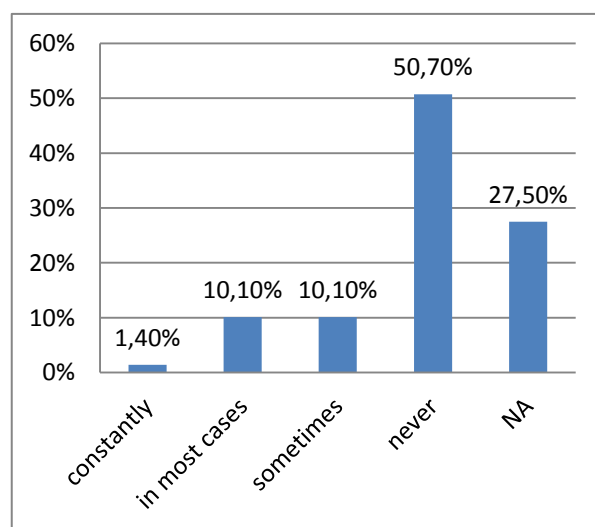


Figure 12 - How frequently companies tend to manipulate VAT?



However, when it comes to ‘manipulating with the VAT’ and ‘employing accounting tricks in order to pay lower taxes’, companies seem less forthcoming to come forward with acknowledgement that this was happening in their sector (Figure 11 and Figure 12).

### 5. Conclusion

The tax burden, one of the main factors that contribute to tax evasion, is the first front where public policies should be targeted in order to change a system that gives incentives for tax evasion and fraud. The tax burden relates not only to the amount paid but also to the ease of, and difficulties involved in, paying such tax and social security contributions. The progressive decrease of the social security contributions in Macedonia, the flat rate income and profit tax, as well as other measures employed by the GoM aimed at improving the business environment are steps in the direction of solving the problems

coming out of excessive tax burdens. The fact that **half of the interviewed businesses agreed that the tax system is good and stimulating for the development of businesses** should be used by the GoM as an impetus to continue with its policy approach concerning the tax system. However, further measures should be focused on positive stimulus and education for tax compliances, in particular as concerns micro and small businesses. Efforts should be focused on also on reducing the tax compliance process. Reforms will be particularly difficult as regards social security contributions, which although seen as fairly higher than they should be by businesses in comparison to other taxes, fail to generate the revenues for sustaining an aging population.

In order to effectively implement measures and improve operational capacities of the government institutions, more research is required on the conditions that lead to the existence of hidden economy in Macedonia in general, and on tax evasion and fraud in particular, in order to capture the country specifics. Moreover, there is evident absence of evaluations of different policies, especially in-depth assessments which go beyond the basic numeric indicators, which prevents more valid estimations of their effectiveness. Finally, the level of enforcement of regulations needs to be strengthened in order for effects to take place.

The GoM has to continue reforming and investing in the operational capacities of the Public Revenue Office, the Financial Police, and the State Market Inspectorate especially in the fields of performance assessment, electronic interconnectedness, data sharing, and electronic services for individuals and businesses. At the same time it has to make sure the tax burden remains low enough to maintain steady increasing revenue, a stimulating business environment, and use past policy experiences to avoid creating incentives that push businesses and individuals towards tax evasion and fraud. Given that the interviewed business representatives have set 'high tax burden' as a third most important factor for the existence of hidden economy (selected by 39% of business representatives), the potential for improvement is large.