TAX SYSTEM REFORM STRATEGY
(2020-2023)

January 2020

EXECUTIVE SUMMARY

The Tax System Reform Strategy ***results from a work started in 2018*** involving main domestic stakeholders[1] as well as international counterparts[2]. It follows the strategic approach to policy making adopted by the Ministry of Finance of the Republic of North Macedonia as per the Public Financial Management Reform Program 2018-2021.

Its main purpose is to ensure that the tax authorities in the Republic of North Macedonia behave in an efficient, coordinated and consistent manner towards achieving a common goal***: inclusive and sustainable economic growth.*** The key issues it intends to address include the persistent informal economy, economic inequality, difficulties in collecting public revenues, techniques for tax avoidance and evasion and increasing environmental risks.

The Strategy ***outlines five priorities for tax policy and tax administration in the period 2020-2023,*** with associated key activities, deliverables, responsible and KPI.

- ***Priority 1 – Increase Fairness of Taxation,*** to ensure that everyone meets its social obligation and pays its fair share of tax. For the next three years, the main focus would be establishing vertical equity, which can be considered more widely than progressivity of taxes. The expected results are a re-designed model for progressive taxation, an implementation of Base Erosion and Profit Shifting (BEPS) minimum standards, a review of national legislation to meet EU expectations.
- ***Priority 2 – Improve Revenue Collection Through Increased Efficiency and Productivity of the Tax System,*** through a review of the tax base, a reduction of tax arrears, the implementation of registry of beneficial owners, a more efficient fight against illicit activities and tax evasion, and a strengthened institutional capacity. Envisaged measures to improve the efficiency and the productivity of the tax collection system include the review of the existing tax regulations, the introduction of advanced technologies, the strengthening of capacities of the institutions, the modernization and automation of working processes, an enhanced institutional coordination as well as a better cooperation at the international level.
- ***Priority 3 – Increase Tax Transparency,*** including an improvement of the exchange of information between tax authorities and other entities, and based in particular on e-services. This priority is expected to result in enhanced fiscal literacy and increased voluntary compliance.
- ***Priority 4 – Improve Quality of Services***, designed to simplify and speed up the procedures and to reduce the administrative burden. The targeted outcomes are more digitized services, a better management of the import-export licenses' issuance, the elimination of unnecessary non-tariff barriers, as well as an in improved internal control and tax audit.
- ***Priority 5 – Introduce Green Taxation***, in order to incentivize tax payers to reduce their polluting behaviors and/or activities. The aim is both to curb pollution and protect natural resources, and to increase government's revenues.

Implementation of the strategy will be composed of the following steps:

- Based on the priorities, measures and activities contained in the Strategy, ***Action Plans will be prepared annually,*** in which all steps for the implementation of the activities related to the respective priorities shall be elaborated in detail.
- ***The implementation of the Strategy will be assessed*** on the grounds of the Performance Assessment Framework, which contains detailed indicators for benchmarking each measure.
- ***Monitoring and reporting of the implementation*** of the Tax System Reform Strategy will be carried out by the Tax System Reform Strategy Working Group (TSRS WG) consisted of Ministry of Finance, Public Revenue Office, Customs Administration, Financial Police Office and Financial

[1] Ministry of Finance, Public Revenue Office, Customs Administration, Financial Intelligence Office and Financial Police Office.
[2] European Union and the Ministry of Finance of the Kingdom of the Netherlands

Intelligence Office. Reports will be reviewed by the Public Financial Management Sector Working Group, approved by the Public Financial Management Council and adopted by the Government.

The tax institutions of the Republic of North Macedonia that have contributed to design this strategy and will be involved in its implementation are the Ministry of Finance, the Public Revenue Office, the Customs Administration, the Financial Intelligence Office and the Financial Police Office.

The authorities are fully aware that the credibility and success of a broad-based tax reform strategy depends critically on the right sequencing of reforms in a manner that exploits the salient economic and political complementarities among individual policy measures. To this end, they aim to implement a reform roadmap that respects these complementarities and thus maximizes the economic yield and gains wider political consent.

Based on this strategy, the TSRS WG will develop an annual action plan which will be published by the end of first quarter each year. The progress of the action plan for each year will be evaluated before publishing the proceeding action plan for the following year.

LIST OF ACRONYMS

ALP	Arm's Length Principle
AML	Anti-Money Laundering
AML/CFT	Anti-Money Laundering/Combating of Financing of Terrorism
BEPS	Base Erosion and Profit Shifting
CA	Customs Administration
CAA	Competent Authority Agreement
CbC	Country-by-Country
CDD	Customer Due Diligence
CDEPS	Customs Declaration and Excise Documents Processing System
CFT	Combating of Financing of Terrorism
CIT	Corporate Income Tax
CRS	Common Reporting Standard
CSOs	Civil Society Organizations
DCS	Diagnostic Control System
EU	European Union
FIO	Financial Intelligence Office
FP	Financial Police
GAAR	General Anti-Avoidance Rule
GDP	Gross Domestic Product
HR	Human Resources
IFFs	Illicit Financial Flows
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession Assistance
IT	Information Technology
LTO	Large Taxpayer Office
MAP	Mutual Agreement Procedure
ML/FT	Money Laundering/Financing of Terrorism
MLI	Multilateral Instrument
MNEs	Multinational Enterprises
MoF	Ministry of Finance

OECD	Organization for Economic Co-operation and Development
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PFM SWG	Public Financial Management Sector Working Group
PIT	Personal Income Tax
PRO	Public Revenue Office
SEE	South-East Europe
SEED	System for Exchange of Excise Data
SOEs	State-Owned Enterprises
SSORM	State Statistical Office of the Republic of North Macedonia
SSCs	Social Security Contributions
TADAT	Tax Administration Diagnostic Assessment Tool
TCF	Tax Control Framework
TP	Transfer Pricing
TPL	Transfer Pricing Law
TSRS	Tax System Reform Strategy
TSRS WG	Tax System Reform Strategy Working Group
UPE	Ultimate Parent Entity
VAT	Value Added Tax

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INTRODUCTION

With the rapid globalization of the trade and financial systems, the liberalization of movement of goods and capital, and the advances in information and communication technology, economic landscapes have changed significantly everywhere in the world.

Besides the positive effects of these developments, they have also posed many challenges to many economies. Economic inequality has been on the rise, not just in most of the developing countries, but also in the emerging economies of South-East Europe, jeopardizing the idea of a society of equal opportunities for everyone. Increased integration and eased movement of capital have put pressure on many governments to lower their tax rates in order to attract companies, leading to a global trend of declining government revenues. Tax avoidance (i.e. legal exploitation of the tax system to reduce tax liabilities), tax evasion (illegal practice of failing to pay tax liabilities) and customs offences have also changed substantially. Traditional forms of customs fraud and tax evasion continue to pose challenges but are further intensified by increases in offshore tax evasion, where funds are being sheltered from the home tax authorities. This often has connections with illicit financial flows, money laundering and terrorist financing. Concerns have also been rising about the environmental sustainability of the existing system, with pollution increasing globally and global warming becoming a serious threat to all countries.

All these developments have put governments, and in particular revenue administrations under greater pressure and require a coordinated and strategic action from their sides. Globalization and liberalization of economic activity and trade, which are transforming business into a world without borders, also require enhanced international cooperation between governments.

Global initiatives such as the G20, the Organization for Economic Co-operation and Development, the World Bank, the International Monetary Fund and the United Nations have indeed emerged stressing the need for financial and tax transparency and cooperation and coordination on tax issues.

In order to adequately address all these issues, the Ministry of Finance of the Republic of North Macedonia, alongside its tax institutions, has decided to adopt a strategic approach to tax policy and administration. The main purpose is to ensure that the activities of the tax institutions are consistent, coordinated and clearly directed towards a common goal - inclusive and sustainable economic growth.

THE APPROACH USED TO DEVELOP THE STRATEGY

The Government of the Republic of North Macedonia adopted a Public Financial Management (PFM) Reform Program in 2017. The Tax System Reform Strategy ('TSRS' or the 'Strategy') follows the framework set out by this program.

It was prepared by the Tax System Reform Strategy Working Group (TSRS WG), established in January 2018 and consisting of representatives from the following institutions:

- Ministry of Finance,
- Public Revenue Office,
- Customs Administration,
- Financial Intelligence Office and
- Financial Police Office.

The working group held regular meetings during January - July 2018 and September-November 2019. During the preparation of the Strategy, a great deal of support was provided by the Delegation of the European Union in the Republic of North Macedonia and the Ministry of Finance of the Kingdom of the Netherlands, for which the Ministry of Finance of the Republic of North Macedonia would like to extend its gratitude. The TSRS was adopted by the Ministry of Finance and approved by the Government in January 2020.

Based on the priorities, measures and activities defined within the Strategy, annual Action Plans will be prepared, in which all steps for the implementation of the activities of the respective year shall be elaborated in more detail. The Action Plans will be prepared by the TSRS WG.

The implementation of the Strategy will be evaluated based on the Performance Assessment Framework, presented in a separate section in this document, which contains detailed indicators for each measure. Mid-term review of the Strategy will be conducted in 2022, by the TSRS WG. Should there be a need for certain amendments to the Strategy before the review, they will be done in the Action Plans.

A public consultation will be held prior to the adoption of the Strategy, by involving main stakeholders, including international organizations, civil society organizations, trade unions, the business community and academia. Once adopted by Government, the TSRS will be published on the website of the Ministry of Finance.

Going forward, the authorities acknowledge the existence of positive spillover effects in the reform process and will strive to exploit them in order to fully ensure that the stated strategy goals will be met. Such positive spillover effects could stem, for example, from the identification of small-scale reforms with relatively small implementation costs and benign political economy ("low hanging fruits") that, in turn, enable much bigger reforms at a later stage. More generally, the authorities appreciate the importance to sequence the reform process in a manner that exploits the strong complementarities of individual policy measures maximizing thus the economic effectiveness of reforms and the political and social support of the process.

Likewise, the Government of the Republic of North Macedonia fully understands the risks of "reform fatigue" and therefore the significance of giving ultimate priority to a narrow set of key reform areas where the scope for change is comparatively large, the returns to scale are increasing, and multiple objectives can be met simultaneously. One such key area is undoubtedly capacity building in tax administration - in terms of human capital, material resources and technology - in order to deliver sustained improvements in tax collection and tax compliance.

The authorities are fully aware that no reform strategy can deliver sustainable and lasting results without the support of the widest possible set of social partners and civil society at large. To this end, the key objectives, the distribution of costs and benefits, and the long-run gains of the reform strategy as a whole will be fleshed out in a detailed and transparent way and will be the subject of a thorough and continuous social dialogue.

The authorities recognize that the pace of reform implementation is a critical but difficult choice of any reform strategy. Swift reform implementation gives momentum to the reform process but carries the risk of an abrupt change in the economic behavior of households and firms. On the other hand, an incremental approach to reform implementation can be safer but carries the risk of steam running out. The authorities intend to address this dilemma in consultation with the social partners and in a way, that is both credible and efficient.

Overall, identification of small-scale reforms with a major potential impact; exploitation of economic and political complementarities; prioritization of reform areas where the scope of reform is substantial; emphasis on capacity building; transparency on the goals, costs and benefits of the reforms; and continuous social dialogue are the key pillars of our strategy and we are fully confident that will deliver sustained and fair gains to all.

1. BRIEF OVERVIEW OF THE TAX SYSTEM IN THE COUNTRY

The total public revenues in North Macedonia amounted to 28,6% of the GDP in 2018 and is among the lowest in Europe. Numbers for 2018 are used as a reference point due to the seasonality in the nature of certain taxes, because using the numbers for the first three quarters of the 2019 would provide a distorted picture of the structure of public revenue. Public revenue in the country consists of: taxes, contributions, customs, fees, revenues from public enterprises and institutions, public loans and financial donations. Leaving aside the capital revenues, donations and other non-tax revenues, taxes and contributions represented 90.7% of the total public revenues.

The most important types of taxes and contributions are as follows:

- Income Taxes;
- Value Added Tax;
- Excise Duties;
- Import Duties;
- Social Security Contributions;
- Property Taxes.

1.1 Income Taxes

The North Macedonian tax system in the area of income taxes is characterized by a flat taxation in PIT as well as for the CIT, both at a rate of 10% at the moment (exempt for the income for games of chance witch are taxed by 15% PIT tax rate). The flat tax rate system was first introduced on January 1st 2007 with a flat rate of 12%, which was further lowered to 10% as of January 1st 2008. Prior 2006 the tax rate on corporate income was proportional and amounted to 15%, while the personal income tax applied a relatively low but still accelerated disaggregated progression, with rates of 15%, 18% and 24%.

The Macedonian tax system as of January 1st 2019 in the area of income taxes was characterized by progressive taxation in PIT (incomes from labor are taxed with two rates i.e. 10% for incomes up to 90,000 MKD and a higher rate of 18% for the amounts surpassing that threshold, while capital incomes were taxed with a flat rate of 15%), and a flat rate of 10% is applied to corporate income (CIT). This reform was introduced with the main purpose of decreasing inequality and improving income distribution. Furthermore, in 2019 for the first time, the PIT was divided into a PIT on labor and a PIT on capital.

The effects from the introduction of the progressive and higher tax rate were analyzed based on preliminary data for the period January 1st - June 30th and compared to the same period in 2018. The findings from the analysis indicated that although the effects from the reform had managed to increase revenues, the revenue generated could have been 51% higher had there not been a change in the behavior of the taxpayers due to the introduction of progressive taxation.

The analysis indicated that tax avoidance most likely occurred. The likely common ways of tax avoidance include opening up accounts in neighboring countries, and transfer of earned incomes to other people (relatives and friends) who have not yet reached the progressive-tax threshold. Therefore, such behavior of the taxpayers artificially improved income distribution, while significantly undermining the fiscal effect. The commitment of the Government to fight the informal economy, as one of the major constraints to economic growth, led to take the decision to suspend the reform.

Based on the assessment, as of January 1st 2020 the Government decided to suspend the PIT reform for 36 months while reintroducing the flat tax rate of 10% for all types of income, except for the income from games of chance (tax rate remains 15%). Income taxes accounted for 17.1% of total budget revenue in

2018 (4.6% of GDP), out of which PIT contributes with 9.3% of the total budget revenue (2.7% of GDP) while CIT yields 7.8% of total budget revenue (2.2% of GDP).

1.2 Value Added Tax

The Value Added Tax is one of the largest contributors to total public revenues, accounting for 26% of total budget revenues in 2018 (7.5% of GDP) and 43% in the total tax revenues. It is comprised of a general tax rate of 18% and a preferential tax rate of 5%. The VAT Law was first adopted in 2000, when the VAT replaced the then turnover tax.

1.3 Excise Duties

As an excise goods, the following are currently listed in North Macedonia:

- Energy product and electricity;
- Tobacco goods;
- Alcohol and alcoholic beverages;

The excise is prescribed in absolute amount per unit of measure (specific excise). For tobacco goods the excise is prescribed as proportional and specific excise.

The excise tax on gross basis participated with a total of 15.2% in total revenues in 2018 (4.34% of GDP in 2018). Approximately 49.4% of total excise is from mineral oils, 40.4% from tobacco products, 6.9% from alcohol and beer and the rest from passenger vehicles and other products. As of January 1st 2020, the passenger vehicles are no longer subject to excise tax, as the Government adopted a new Law on motor vehicles that expands the tax basis to include other types of vehicles and introduces the CO_2 emissions as a basis for taxation beyond the current ad valorem tax.

1.4 Import duties

Import duties are relatively low in Macedonia, due to the high degree of trade liberalization. They constitute 3% of the total budget revenue (0.9% of GDP) in 2018.

1.5 Social security contributions

Social security contributions are the biggest source of public revenue, with a 30% share in total revenue in 2018.The share of social security contributions in GDP amount to 8.6% of GDP.

They are calculated on the gross salaries of the insured persons and represent revenues for the respective social funds that finance the current and future rights of the insured persons - rights to health care, use of pension or unemployment benefits.

Starting from 1 January 2020 the total social contributions amount to 28% of the gross salary (18.8% for pension insurance, 7.5% for health insurance, 1.2% for unemployment insurance and 0.5% for additional health insurance). They are capped at 16 average gross salaries, meaning that if someone earns more than this amount, his/her basis for calculating the contributions would still be 16 average gross salaries.

1.6 Property taxes

Property taxes are the main revenue source of the municipalities, as part of the process of fiscal decentralization. There are three types of property taxes:

> Recurrent property tax- the tax rate varies from 0.10% to 0.20% of the market value of the real estate and it is paid annually;
> Gift and inheritance property tax - the tax rate varies from 2% to 5% of the market value of the real estate, depending on the order of inheritance;
> Tax on transfer of property - tax rates range from 2% to 4%.

The exact tax rates in each municipality are specified by the municipality itself, with the Law specifying the range for the rates and specifying that the rates are proportional (flat).

Total revenues from property taxes amounted to 0.5% of GDP in 2018, being among the lowest in Europe.

1.7 Benchmarks

As tax policy has become a key arena of competition across countries, in particular when it comes to attracting foreign direct investments, two benchmarks are worth considering:

> Table 1 compares the tax rates in North Macedonia with its regional peers;
> Table 2 compares the tax rates of selected European Union countries, European Union average and Euro Area average.

It can be seen that North Macedonia has among the lowest tax rates for all the taxes.

Table 1.1 Tax rates in countries from the region in 2018

	North Macedonia	Serbia	Albania	Kosovo	Bulgaria	Croatia	Slovenia
PIT	10% flat	10%-20%	13%-23% progressive	4%-10% progressive	10% flat	24%-36% progressive	16-50% progressive
CIT	10% flat	15% flat	0-15% progressive	10% flat	10% flat	12%-18% progressive	19% flat
VAT	18% regular, 5% preferential	20% regular, 10% preferential	20% regular, 6% preferential	18% regular, 8% preferential	20% regular, 9% preferential	25% regular, 13% and 5% preferential	22% regular, 9.5% preferential
Compulsory social contributions (all)	27%	37.8%	27.9%	10%	23.7% to 24.4%	37.2%	38.2%
Property tax, recurrent	0.1%-0.2%	0.4%-2%	0.05-0.15%	0.05%-1%	0.15%	N/A	N/A
Property tax, transfer	2%-4%	5%	1%	N/A	2%	5%	2%

Table 1.2 Tax rates in European Union countries

	Average EU	Average Eurozone	Austria	Czech Republic	Germany	Greece	Italy	Slovakia
PIT	39,4% (average max)	43,2% (average max)	0,0% - 50,0% (progressive)	15,0% (flat)	14,0% - 47,5% (progressive)	22,0% - 55,0% (progressive)	23,0% - 47,2% (progressive)	19,0% - 25,0% (progressive)
CIT	16,0%	16,2%	17,2%	20,2%	16,8%	15,1%	19,5%	29,3%
VAT	21,5% (standard)	20,8% (standard)	20,0% (standard) 10,0% (reduced)	21,0% (standard) 10,0% (reduced)	19,0% (standard) 7,0% (reduced)	24,0% (standard) 6,0% (reduced)	22,0% (standard) 4,0% (reduced)	20,0% (standard) 10,0% (reduced)
Compulsory social contributions (all)	24,2%	26,7%	30,6%	30,8%	25,5%	34,8%	28,5%	28,7%
Property tax, recurrent	N.A.	N.A.	0,1%	0,2%	0,3%	1,5%	0,7%	0,4%

Source: Taxation trends in European Union, 2019 and Tax Foundation for Property tax, 2019

2. ASSESSMENT OF THE MACEDONIAN TAX SYSTEM BY INTERNATIONAL ORGANIZATIONS

2.1 World Bank

In its Public Finance Review for 2018[3], the World Bank provides the following key recommendations for North Macedonia in the area of taxation:

> Adoption of a more progressive personal income tax structure with higher marginal rates for high income earners. This would increase revenue collection and make the tax more equitable.
> Broadening of the personal income tax base by removing exemptions on specific capital income and gains. This would significantly increase tax revenues and the progressiveness of the income tax system.
> Broadening of the value - added tax base through the removal of preferential treatment of selected goods and services. The wide range of reduced rates creates opportunities for abuse, while a broad-based standard VAT improves economic and administrative efficiency. VAT is an ineffective redistributive tool.
> Increase of the excise taxes on tobacco, coal, and diesel. This will lead to both higher revenues and improvements in other social outcomes, such as health and pollution.
> Exploration of whether the government's investment incentive strategies have been beneficial via cost-benefit analysis. To determine if support for TIDZs is an efficient use of public revenues, an analysis needs to be made. These incentives result in net fiscal costs for the government in terms of discarded tax revenues, grants, administrative costs, and compliance costs, distortion effects of revenue decrease and distorted resource allocation from the incentive.
> Assess which tax incentives in the CIT to maintain, on the grounds of tax expenditure review.
> Increase the CIT rate, to bring it closer to the peers (close to 15%). In this way, revenues will be increased and the tax burden between capital and labor will be rebalanced.
> Implement the recommendations of the TADAT assessment to modernize the tax administration. Challenges remain, including personnel constraints. Investing in the Public Revenue Office is particularly important at a time when major tax reforms are being considered.

2.2 IMF

In order to improve the efficiency and fairness of the tax system in the Republic of North Macedonia, the International Monetary Fund has recommendations regarding tax progressivity, tax efficiency, transfer pricing and the working of the tax administration.

The Selected Issues Paper for 2017[4] focuses on progressivity and efficiency. Concerning progressivity, the government's plan to adopt a progressive personal income tax system is encouraged, but related parameters need to be designed carefully. This means that appropriate income tax bracket thresholds and deductibles should be designed to make the proposed two-rate structure progressive in practice.

Making other taxes more progressive could be also a good base for increasing revenues. Increasing the property tax rate for high-valued property could be an additional source of revenue, but once the rate is increased, it is crucial to ensure assessment and audit capacities to avoid underreporting of the property values.

[3] World Bank (2018), FYR Macedonia Public Finance Review
[4] IMF (2017), Republic of Macedonia—Staff Report for the 2017 Article IV Consultation, Selected Issues Paper

Regarding tax efficiency, efforts should be focused primarily on risk management and management of tax arrears. More precisely, the priority measures should continue in the following:

> Strengthening risk management. In this regard, currently, there is no systematic approach to identify, assess, quantify, and prioritize compliance risks.
> Strengthening the management and collection of tax arrears. Tax arrears are significant at about 38.6 percent of core tax revenues during the period of 2013–2015. It is also underlined that the amount of uncollected debt older than 12 months has increased substantially in recent years.
> Improving the efficiency and operation of the Large Taxpayers Office.

The IMF report on transfer pricing in Macedonia[5] provides several recommendations related to:

> Measures to strengthen the control on profit shifting. This should be done by establishing the presentation of TP documentation as a condition for deduction of related party expenses; introducing an obligation of filing an annual disclosure form on transactions with related parties; introducing specific TP penalties for the omission of tax and failure to file TP documentation or the annual disclosure form.
> Complementary Measures for a Comprehensive Strategy on Transfer Pricing. The recommendations here are: redrafting General Anti Avoidance Rule in the law aiming to re-characterized the legal form of the transaction for tax purposes to reflect the real nature of the operation; introducing the possibility for the PRO to issue advance pricing agreement; considering for the possibility of introducing a TP safe harbor for simple contract manufacturing activities.

The TADAT report points out the following areas for improvement[6]:

> Formal administrative dispute review process is limited. Related to this there is no graduated mechanism of administrative and judicial review available to taxpayers.
> The tax audit program does not provide adequate coverage.
> VAT refunds are not reviewed using a proper risk-based verification process, and less than 50 percent of VAT refunds were paid (or rejected) within the TADAT 30-day standard.

Regarding **2019 ARTICLE IV Consultation**, the IMF has several recommendations and comments about taxation, tax rates and tax administration in The Republic of North Macedonia.

> Strengthening revenue administration efficiency and compliance should be the priority, combined with measures that raise public trust in institutions and tax morale.
> Stronger tax administration and labor inspections are essential to reduce informal activity, but also emphasized the role of fiscal incentives such as MyVAT to encourage VAT registration and the subsidy on social security contributions to reduce envelope payments.
> The tax burden overall does not appear as a major obstacle to formal businesses. Both corporate and value added tax rates are low compared to other European countries.
> Ineffective tax administration provides incentives for tax evasion and undeclared work. Tax collection efficiency is weak in North Macedonia. Partly reflecting a lack of resources, the extent of initiatives to detect unregistered taxpayers and inaccurate reporting is limited.
> Conditional on a strong tax administration, in-work tax credits could be considered to stimulate formal employment of low-income workers.

[5] IMF (2017), Macedonia, Reforming The Transfer Pricing Regime
[6] IMF (2016), Macedonia TADAT Performance Assessment Report

2.3 European Commission

The **progress report for 2019**[7] notes that the country is moderately prepared in this area. Some progress was made in reducing the administrative burden for taxpayers and in shortening the time needed to process annual income tax returns. In the coming year, the recommendations from the previous year remain valid and the country should in particular:

- Improve the capacity of the central and local tax administration by adopting and efficiently implementing the tax system strategy;
- Further align the legal framework with the acquis, in particular the Law on Excise Tax, and amend the Laws on Personal Income Tax and Tax Procedures in accordance with the tax system strategy;
- Ensure the ratification of the OECD Multilateral Convention on mutual administrative assistance in tax matters by the end of 2019.

The **EU Code of Conduct for Business Taxation** noted deficiencies in three areas: Tax Transparency, Fair Taxation and implementation of anti-BEPS measures.

- Regarding **Tax Transparency**, the criteria that a jurisdiction should fulfill in order to be considered compliant on tax transparency are:
  - Initial criterion with respect to the OECD Automatic Exchange of Information (AEOI) standard (the Common Reporting Standard — CRS): the jurisdiction, should have committed to and started the legislative process to implement effectively the CRS, with first exchanges in 2018 (with respect to the year 2017) at the latest and have arrangements in place to be able to exchange information with all Member States, by the end of 2017, either by signing the Multilateral Competent Authority Agreement (MCAA) or through bilateral agreements; future criterion with respect to the CRS as from 2018: the jurisdiction, should possess at least a 'Largely Compliant' rating by the Global Forum with respect to the AEOI CRS; and

  - The jurisdiction should possess at least a 'Largely Compliant' rating by the Global Forum with respect to the OECD Exchange of Information on Request (EOIR) standard, with due regard to the fast track procedure; and

  - For sovereign states, the jurisdiction should have either:

    - Ratified, agreed to ratify, be in the process of ratifying, or committed to the entry into force, within a reasonable time frame, of the OECD Multilateral Convention on Mutual Administrative Assistance (MCMAA) in Tax Matters, as amended; or

    - A network of exchange arrangements in force by 31 December 2018 which is sufficiently broad to cover all Member States, effectively allowing both EOIR and AEOI;(for non-sovereign jurisdictions) the jurisdiction should either:

    - Participate in the MCMAA, as amended, which is either already in force or expected to enter into force for them within a reasonable timeframe; or

    - Have a network of exchange arrangements in force, or have taken the necessary steps to bring such exchange agreements into force within a reasonable timeframe, which is sufficiently broad to cover all Member States, allowing both EOIR and AEOI;

[7] European Commission (20189, Commission Staff Working Document, The Republic of North Macedonia

- Future criterion: in view of the initiative for future global exchange of beneficial ownership information, the aspect of beneficial ownership will be incorporated at a later stage as a fourth transparency criterion for screening.

> As for **Fair taxation**, the criteria that a jurisdiction should fulfill in order to be considered compliant on fair taxation are:

- the jurisdiction should have no preferential tax measures that could be regarded as harmful according to the criteria set out in the Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation (1); and
- the jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction.

> Regarding **Implementation of anti-BEPS measures**, the criteria that should be met in order to be considered compliant are:

- The jurisdiction should commit, by the end of 2017, to the agreed OECD minimum standards against BEPS and their consistent implementation.
- Future criteria that need to be fulfilled to be considered with the implementation of the anti-dumping measures (which will apply once the Inspection Framework for agreed minimum standards is completed).
- Jurisdiction should receive a positive assessment of the effective implementation of the agreed minimum OECD standards against BEPS.

The PEFA 2015 Assessment[8] of the Republic of North Macedonia assesses the country as relatively poorly in the three tax-related areas, Transparency of taxpayer obligations and liabilities (C+), Effectiveness of measures for taxpayer registration and tax assessment (C+) and Effectiveness in collection of tax payments (D+).

Regarding the first area, the lowest rating (D) is in the field of Existence and functioning of a tax appeals mechanism, due to the abolition of the administrative appeals system in the MoF in 2015.

In the second area, both Controls in the taxpayer registration system and Effectiveness of penalties for non-compliance with registration and declaration obligations are ranked with C, the issue with the first one being that the databases for the main taxes are not yet integrated, and the links to other databases have yet to be developed. The issue with the second is that the penalties available to PRO must be improved.

The third area, Effectiveness in collection of tax payments, is given the lowest grade, due to the poor collection ratio for gross tax arrears (D), and the separate IT system for each tax (D).

2.4 Organization for Economic Co-operation and Development

The OECD report "Competitiveness in South East Europe: A Policy Outlook 2018"[9] gives recommendations in the field of tax policy, tax administration, and international tax and tax cooperation.

In relation to **tax policy**, the key points are directed to:

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[8] John Wiggins, Jean-Marc Philip, BojanPogačar and Anto Bajo (2015), PEFA Assessment of the Former Yugoslav Republic Of Macedonia Report, December 2015

[9] Organization for Economic Co-operation and Development (2018) "Competitiveness in South East Europe: A Policy Outlook 2018"

- Low statutory CIT rates, ranging between 9% and 15%.
- The wide-range of corporate tax incentives. SEE economies have generous profit-based CIT incentives, and some of them also have expenditure-based CIT incentives, which reduce the cost of investment.
- The tax wedge on labor income. The tax wedge is rather high despite relatively low PIT rate. SEE economies impose relatively low PIT rates, but they levy high SSCs. This can lead to high overall tax burden on labor income. Additionally, the average tax wedge is highly regressive in three out of the six economies, due to the minimum and maximum amounts of SSCs.
- Bringing more taxpayers within the formal economy and increasing tax compliance. Governments have different tools available to achieve this objective including targeting their audit capacities to those agents who are more likely to evade taxes and operate in the informal economy.
- A well-designed VAT system, that could help reduce the informal economy. SEE economies levy relatively high VAT rates on a narrow VAT base and the VAT registration thresholds are relatively high. They would benefit from broadening the VAT bases having in mind that VAT regimes across the region provide for a long list of VAT-exempted goods and services, and many of the exemptions and reduced rates are not well targeted. They may also consider for gradually lowering the registration thresholds over time, as they continue strengthening their tax administration capacity.
- The need to strengthen the tax policy analytical capacity and to prepare tax expenditure reports on a regular basis. All SEE economies would benefit from the implementation of micro-simulation models and the introduction of systematic tax expenditure reporting. SEE economies should strengthen their tax policy assessment tools, including the development of corporate effective tax rate models and Taxing Wages models.

Connected with **tax administration** the key recommendations are directed to:

- Compliance assessment and risk management. Compliance assessment and risk management have improved across the SEE region. In this regard, tax administrations should have an on-going process that allows them to consider the areas of compliance risk within their economy in order to be efficient in the monitoring of the compliance and managing risks. Associated with the risk auditing process it is necessary to include third party reporting systems, and developing of these systems especially in combination with the withholding regimes is a proven way for improving the tax compliance, risk analysis and risk treatment, and allowing better target tax audits where it's required.
- Tax filing and payment procedures. The use of e-filing is widespread, but e-payment is not yet available. Complying with tax obligations requires internal and/or external resources that can particularly burden small and medium-sized business. In this line, the procedures should be streamlined to limit the compliance burden imposed on businesses. SEE economies reported that the length of tax filing and payment procedures are reasonably short and procedures to be relatively simple. All SEE economies have e-filing procedures available for most if not for all taxes, which contributes to reducing the complexity of the filing procedures.
- Taxpayer services. Bosnia and Herzegovina, the Republic of North Macedonia, Montenegro and Serbia do not have a taxpayer ombudsman that is easily accessible by taxpayers. All SEE economies should continue making efforts to modernize their tax administration through automation, risk-based compliance assessments, and by increasing the number and the training of the staff employed in the tax administration, etc.

In the field of **international tax and tax cooperation** the recommendations are connected with:

- Preventing tax treaty abuse;
- Aligning of the SEE economies tax systems with the best practices in the international taxation;
- More effective exchange of financial account information for tax purposes;
- Aligning transfer pricing rules with the OECD Transfer Pricing Guidelines;
- Improving the design of the SEE economies thin capitalization rules and intensive tax coopertion.

3. PRIORITIES, MEASURES AND ACTIVITIES OF THE STRATEGY

On the grounds of the presented information so far, the Tax System Reform Strategy identifies the following key reform priorities:

- Priority 1 – Increase Fairness of Taxation;
- Priority 2 – Improve Efficiency and Productivity of the Tax System;
- Priority 3 – Increase Tax Transparency;
- Priority 4 – Improve Quality of Services;
- Priority 5 – Introduce Green Taxation.

Each priority is elaborated in more detail in the following chapters.

3.1 Priority 1: Increase fairness of taxation

Objective

The objective of this priority is to increase fairness in the tax system in the country, where fairness describes a system of taxation that is equitable for everybody that is obliged to pay taxes according the law. Groups focused on tax fairness look to limit the amount of tax legislation and rules that benefit one segment of the tax-paying population over another. In other words, tax fairness is about everyone meeting their social obligation to pay their fair share.

The main focus of the fair taxation for the next three years would be establishing vertical equity, which can be considered more widely than progressivity of taxes. The Government achieves distributional goals through transfers and other government expenditure.

Thus, this priority will be achieved through the following measures and activities.

Measure 1.1: Review the existing tax policy and introduce improvements

- Activity 1.1.1: Review and implementation of the right model of progressive PIT
- Activity 1.1.2: Analyze of the tax rate of CIT
- Activity 1.1.3: Review of existing property tax system
- Activity 1.1.4: Review of compulsory social security contributions threshold and maximum pension amount

Measure 1.2: Ensuring fair competition

- Activity 1.2.1: Countering Harmful Tax Practices More Effectively
- Activity 1.2.2: Preventing the granting of treaty benefits in inappropriate circumstances
- Activity 1.2.3: Transfer Pricing Documentation and Country-by-Country Reporting
- Activity 1.2.4: Making Dispute Resolution Mechanisms More Effective

Measure 1.3: Harmonization with EU and best practices

- Activity 1.3.1: Harmonization in the field of VAT
- Activity 1.3.2: Harmonization in the field of PIT
- Activity 1.3.3: Harmonization in the field of CIT
- Activity 1.3.4: Harmonization in the field of excise duties
- Activity 1.3.5: Introduction of data standards for e-commerce through harmonization of relevant tax legislation

- Activity 1.3.6: Prepare for the tax challenges of the Digital Economy and “digital taxation”
- Activity 1.3.7: Harmonization in the field of administrative cooperation in direct taxation

Priority results

- Proposal of new re-designed model for progressive taxation;
- Implemented minimum BEPS standards;
- Improved tax legislation (PIT, CIT, VAT, excise duties) in accordance with EU and best practices;

Indicators[10]

- Reduced inequality of income distribution, S80/S20 %;
- Increased PIT revenues;
- Increased CIT revenues;
- Increased VAT revenues;
- Increased revenues from excise duties.

Measure 1.1: Review existing tax policy and introduce improvements

Objective of the measure

The objective of this measure is to address the weaknesses of the existing tax system, by simplifying it, eliminating the self-taxation elements through the introduction of automation in the relevant tax authorities that administer the collection and decreasing the tax burden on both sides, thus increasing its efficiency.

Background

The Republic of North Macedonia has had a proportional (flat) personal income tax, proportional (flat) property tax, and regressive social security contributions from 2007 onwards. A progressive and higher PIT tax rate of 18% was introduced, as a second rate to the existing 10% rate for the income from labor above the threshold of 90,000 MKD from January 1st 2019. The effects of the progressive tax rate were analyzed by external experts based on actual data for the period January 1st - June 30th for 2018 and 2019 and the main finding indicated the following:

- Fiscal effects - for the first half of the year, the progressive and higher PIT rate contributed with 12.7 million EUR to public revenues, which is in line with the original budget projections. However, the potential of the PIT reform, based on 2018 data, has been estimated at 19.2 million EUR. Therefore, when this was applied, we arrived at 51.2% lower fiscal effect from the PIT reform.
- Distributional effects - the analysis indicated that tax avoidance most likely occurred. The probable common ways of tax avoidance include opening up accounts in neighboring countries, and transfer of earned incomes onto relatives and friends who have not yet reached the progressive-tax threshold. Therefore, such behavior of the taxpayers artificially improved income distribution, while significantly undermined the fiscal effect.

As already mentioned in the description of the tax system of the country, the key findings from the 3rd party analysis have led to the postponement of the PIT reform by 36 months. This time will be used to focus on improving the proposed tax reform by implementing the activities described below.

[10] Indicators are elaborated in details in the section on Performance Assessment Framework

Activity 1.1.1. Review and implementation of the right model of progressive PIT

The 36 months suspension period of the progressive PIT tax rate will be used to focus on improving the proposed tax reform in terms of taking into consideration the introduction of the view of the household income, despite taxing the individual as well as the possibility to increase the progressivity by adding additional rates.

When the new PIT law was adopted in 2019 in which the flat rate was introduced once again, the Ministry has announced that the period the 36 months suspension period of the progressive PIT tax rate will used for building a more efficient system that will generate higher revenue from PIT. That system will help for more efficient tax collection where the withheld income tax from the payer will be dominate, for all the types of income. Also, the income that is not tax at the moment (income from interest from savings deposits and income from capital gains) will be taxed by withholding the tax from the payer.

Activity 1.1.2 Analyze of the tax rate of CIT

The corporate income tax rate in the Republic of North Macedonia is currently at a 10% flat rate for all companies ranging from startups and SMEs to large enterprises, except companies that are in simplified tax regime or the companies that are using state aid. The need for a detailed analysis of the effective CIT rate that companies pay has been acknowledged, as there are larger companies that are the beneficiaries of tax credits and incentives under the current system.

The results of the assessment of the current state of tax collection indicate the need for further analysis of the effective tax rate on profit tax, in line with best practices from the EU and similar countries, together with a full analysis of the potential impact on the market, how companies are ready to pay taxes and keep in mind the easier migration of capital.

Activity 1.1.3 Review of existing property tax system

The current property tax in the Republic of North Macedonia is currently proportional (flat). The rate is determined by the local governments (municipal councils), and can range between 0.1% and 0.2%, but cannot be progressive, i.e. the same rate applies to everyone in the municipality. It is recognized that this contributes to the increase of wealth inequality, and through it, income inequality.

In order to resolve this issue, a detailed analysis will be done in order to introduce the fair value of the taxable property, in other words the tax rate to be calculated at the real estate value at the time of taxation.

In the question of fairness, the possibility of property being taxed fairly according to the value of the property will be considered.

Activity 1.1.4. Review of compulsory social security contributions threshold and maximum pension amount

Social security contributions in the Republic of North Macedonia are in total 28% (in 2020) of the gross salary and are capped, i.e. there is a highest possible base for calculating the contributions, equal to 16 average gross salaries. This means that the highest amount of social security contributions that can be paid is approximately 2600 euros per month.

The working group will make detailed analysis to assess the threshold justification for the highest basis for calculating contributions and together with an assessment of the pension fund's stability and its capacity to provide retirees who have met the requirements for seniority and lifetime retirement income pension.

If the analysis found that there is space for increasing the highest amount of retirement pension income, then the review for the threshold for the highest contribution base, will be made.

Table 3.1 Implementation of the measure 1.1 - Review existing tax policy and introduce improvements

Period for finalization	2023
Deliverables[11]	Review of the model of progressive PIT Review of the effective CIT tax rate Implementation of the fair value of the taxable property Adopted Amendments to the Law on Social Insurance and Law for Pension and Disability Insurance
Costs	These activities will be implemented through regular working duties of employees of the relevant institutions. In addition, technical assistance will be requested by the World Bank Total costs for salaries are estimated at 21,300 euros.
Responsible body	Ministry of Finance, Ministry of Transport and Communications
Risks	Insufficient political will for implementing the changes. Lack of qualified experts for drafting the legal Amendments. Insufficient support from stakeholders.

Measure 1.2: Ensuring fair competition

Objective of the measure

The objective of this measure is to set forth a clear and effective domestic framework for fair and competitive taxation aligned with the Base Erosion and Profit Shifting (BEPS) package. This will be done by implementing the following four minimum standards of the BEPS package:

> Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance (BEPS Action 5);
> Preventing the granting of treaty benefits in inappropriate circumstances (BEPS Action 6);
> Transfer Pricing Documentation and Country-by-Country Reporting (BEPS Action 13) and
> Making Dispute Resolution Mechanisms More Effective (BEPS Action 14).

Background

The main purpose of BEPS is to tax profits at the place where the economic activity takes place and the value is created. BEPS aims to address tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations, resulting in little or no overall corporate tax being paid. BEPS solutions aim at creating tools which can be used by the tax authorities to avoid these activities. BEPS also creates certainty for the companies by reducing the disputes related to implementation of the international taxation rules. The BEPS package consists of 15 standards, 4 of which are a minimum requirement.

The Inclusive Framework on BEPS was designed and agreed by the OECD following a call from G20 leaders for increased inclusiveness in the international tax rules. Republic of North Macedonia is already a BEPS Associate and is going to be able to work with the OECD and G20 countries on developing standards on BEPS-related issues and the implementation of the monitoring processes. As a BEPS Associate the Republic of North Macedonia is committed to implement the four minimum standards.

[11]Deliverables refer to end results based on prior extensive analysis and are subject to revision based on key findings and results from said analysis

Activity 1.2.1. Countering Harmful Tax Practices More Effectively

BEPS Action 5 minimum standard is focused on requiring substantial activity for any preferential regime and on improving transparency, including compulsory spontaneous exchange of information on certain tax rulings.

Within this activity the country will take the necessary steps to evaluate the national legislation in relation to whether there are preferential regimes that allow artificial profit shifting and whether there is an adequate level of transparency in connection with certain rulings in context with Action 5 minimum standard of BEPS. With this activity, the country will also consider if there is a need for revisions to the existing legislation.

Activity 1.2.2. Preventing the granting of treaty benefits in inappropriate circumstances

BEPS Action 6 minimum standard refers to treaty-shopping, i.e. to cases where multinational companies try to take advantage of more favorable tax treaties that are available in certain jurisdictions.

Within this activity the country will take the necessary steps to examine which provisions from the minimum standard on treaty-shopping should be included in the tax treaties that the Republic of North Macedonia has, in order to ensure a minimum level of protection against treaty-shopping.

There are two approaches to implement this standard, through a multilateral instrument and through reviewing the bilateral treaties with other jurisdictions. The Republic of North Macedonia will implement the minimum standard from BEPS Action 6 through Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). The MLI was signed by the Minister of Finance in January 2020 at the 8th BEPS Inclusive Framework meeting at OECD and process of ratification will follow.

Activity 1.2.3. Transfer Pricing Documentation and Country-by-Country Reporting

BEPS Action 13 minimum standard refers to transfer pricing. The BEPS Action 13 Report introduces a standardized three-tiered approach to transfer pricing documentation for multinational enterprises (MNEs) consisting of a master file containing standardized information relevant for all MNE group members, a local file referring specifically to material transactions of the local taxpayer and an obligation on certain MNE groups to annually file a Country-by-Country Report containing certain information relating to the global allocation of the MNE group’s income and taxes paid together with certain indicators of the location of economic activity within the MNE group (CbC Report).

The first step in implementing CbC Reporting is to have a legal and administrative framework that requires certain MNE groups to file CbC Reports in accordance with the Action 13 minimum standard and ensures the confidentiality, consistency and appropriate use of the information contained in those reports. Also in the manner of Action 13 minimum standard there is a need for legal base for exchange that sets out the terms of the exchange where the UPE or surrogate entity of an MNE group files a CbC Report with the tax authority in its residence jurisdiction with tax authorities in other jurisdictions where constituent entities in that group are either resident for tax purposes or subject to tax with respect to a business carried on through a permanent establishment.

Activity 1.2.4. Making Dispute Resolution Mechanisms More Effective

The BEPS Action 14 Report discusses the obstacles that prevent countries from resolving treaty-related disputes under the mutual agreement procedure (MAP) and recommends measures to overcome such obstacles, including a set of minimum standards to ensure that treaty-related disputes are resolved in a timely, efficient and effective manner.

Table 3.2 Implementation of the measure 1.2 - Ensuring fair competition

Period for finalization	End of 2020
Deliverables	Adopted amendments of tax legislation related to BEPS. Updated tax treaties. Ratified MLI Signed Competent Authority Agreement
Costs	Annual membership fee of 20,000 EUR, cost for technical assistance of 10,000 EUR, salaries for employees of 21,600 EUR.
Responsible body	Ministry of Finance, PRO
Risks	Lack of expert technical assistance. Insufficient human resource capacities.

Measure 1.3: Harmonization with EU and best practices

Objective of the measure

The objective of this measure is to improve the harmonization of the legislation in the field of taxation in line with the relevant EU acquis and best practices.

Background

One of the main preconditions for European integration is the harmonization in the area of taxes, i.e. the harmonization of the national tax systems of the countries that aim to integrate into the European common market. The Republic of North Macedonia as a candidate country from 2005, will continue to analyze all relevant EU acts in the field of direct and indirect taxation, for the purpose of their transposition in the national legislation in order to achieve full harmonization.

Activity 1.3.1. Harmonization in the field of VAT

The Value Added Tax is a part of the *acquis communautaire*. The taxation of the consumption of goods and services in the Republic of North Macedonia is regulated by the Law on Value Added Tax that incorporates the EU requirements for VAT system. In order to achieve better alignment with the EU legislation, during the next period the Government will continue to assess the VAT tax legislation and to create the draft acts related to VAT. This will be done with expert assistance within the EU project framework, aiming to align countries efforts with the requirements of Chapter XVI - Taxation.

Activity 1.3.2. Harmonization in the field of PIT

The Personal Income Tax is a part of the *acquis communautaire*. The Personal Income Tax Law regulates the taxation procedure of the citizens' personal income realized during the year as a sum of the following types of income: income from work, income from independent activity, income from property, income from authorship and industrial property rights, income from capital, capital gains, income from games of chance and other income. In order to achieve better alignment with the EU legislation, during the next period the Republic of North Macedonia will continue to assess the PIT legislation and to create the draft acts related to PIT. This will be done with expert assistance within the EU project framework.

Activity 1.3.3. Harmonization in the field of CIT

The Corporate Income Tax is a part of the *acquis communautaire*. The profit generated by the legal entities, residents and non-residents of the Republic of North Macedonia, is regulated by the Profit Tax Law. During the next period the Republic of North Macedonia will continue with the assessment of the CIT legislation and with the preparation of the draft acts in order to achieve better alignment with the EU legislation. In this process, the Republic of North Macedonia will be supported by the expert assistance within the framework of the EU project.

Activity 1.3.4. Harmonization in the field of excise duties

The excise duties are part of the *acquis communautaire*. The Law on Excise Duties is the basic legal act for regulating the excise duties that are charged indirectly or directly for the consumption of goods on the territory of the Republic of North Macedonia or from import. The products that are subject to excise duties according to the new Law on Excise Duties are: energy products and electricity, alcohol and alcoholic beverages and tobacco products. In order to achieve better alignment with the EU legislation the Republic of North Macedonia will continue with the assessment of the excise duties legislation.

Activity 1.3.5. Introduction of data standards for e-commerce through harmonization of relevant tax legislation

E-commerce has an important role in the international trade as it provides for innovative solutions in the trade environment. Efficiency of clearance and delivery of low value and small parcels is especially crucial. To manage the e-commerce transactions, the Customs administration needs to engage with all relevant stakeholders to collectively define the appropriate approach to adopt trade facilitation and an enforcement perspective.

Activity 1.3.6: Prepare for the tax challenges of the Digital Economy and “digital taxation”

The digital economy provides numerous benefits for citizens, companies and governments. But at the same time the new digital world and digital services as well as new business models pose challenges to existing tax systems. Numerous challenges arise, including determining the location where value is created, where the tax should be paid when someone is providing digital services across the world, and so on. Some countries believe that multinational profits should be taxed where value is created, while others argue that value for companies in the digital economy is coming from several factors, namely the final user participation and the user’s location.

The European Union is working on a system for preparing and adapting member states' tax systems to align with the digital age. Also, Action 1 in the BEPS inclusive framework of OCED is dedicated to tax challenges arising from the digitalization of the economy aiming to create comprehensive and transparent international tax rules. This activity will be in the direction of preparing our tax system for the digital world and digital taxation.

Activity 1.3.7. Harmonization in the field of administrative cooperation in direct taxation

Administrative cooperation in direct taxation between the Competent Authorities helps to ensure that all taxpayers pay their fair share of the tax burden, irrespective of where they work, retire, hold a bank account and invest or do business. EU acquis provides for the exchange of specified information in three forms: spontaneous, automatic and on request and provides for other forms of administrative cooperation. During the next period the Republic of North Macedonia will review its national legislation in order to align it with the EU acquis in the field of administrative cooperation.

Table 3.3 Implementation of the measure 1.3 - Harmonization with EU and best practices

Period for finalization	2023
Deliverables	Implemented amendments to the Law on VAT. Implemented amendments to the Law on PIT. Implemented amendments to the Law on CIT. Implemented new Law on Excise Duties (2020). Implemented Amendments in the Law for E-commerce and new Operational Guidance for E-commerce. Analysis and joining the Action 1 of BEPS IF
Costs	1 million EUR for technical assistance, 302,400 EUR for salaries of employees.
Responsible body	Ministry of Finance, PRO and Customs Administration
Risks	Lack of expert technical assistance. Insufficient human resources capacities. Insufficient political will.

3.2 Priority 2: Improve Revenue Collection Through Increased Efficiency and Productivity of the Tax System

Objective

The objective of this priority is to improve the efficiency and productivity of the tax collection system. A series of measures will be taken towards that end, consisting of improvement in the existing tax regulations, introduction of advanced technologies, strengthening of capacities of the institutions, modernization and automation of working processes, strengthening of institutional coordination and cooperation at the international level.

This objective will be achieved through the following measures and activities:

Measure 2.1: Analysis of the tax base

> Activity 2.1.1: Analysis of tax deductions in PIT
> Activity 2.1.2: Analysis of tax deductions in CIT
> Activity 2.1.3: Analysis of VAT preferential list

Measure 2.2: Reduction of tax arrears

> Activity 2.2.1: Addressing tax arrears of SOEs
> Activity 2.2.2: Addressing accounts uncollectible and development of software for managing debt of the taxpayers

Measure 2.3: Reduction of tax evasion

> Activity 2.3.1: Reduction of use of cash
> Activity 2.3.2: Improvement of fiscalization
> Activity 2.3.3: Improvement of VAT refund mechanisms to citizens
> Activity 2.3.4: Accreditation of customs laboratory
> Activity 2.3.5: Improvement of risk prevention and management by PRO and CA

- Activity 2.3.6: Regulation of unregistered businesses
- Activity 2.3.7: Preparing reports on trends in tax avoidance

Measure 2.4: Addressing illicit financial flows

- Activity 2.4.1: Implementation of Registry of Beneficial Owners
- Activity 2.4.2: Increasing efficiency of measures for illicit financial flows

Measure 2.5: Improving capacities of institutions of the tax system

- Activity 2.5.1: Human resources development
- Activity 2.5.2: Improvement of non-intrusive equipment of CA
- Activity 2.5.3: New integrated IT system of PRO
- Activity 2.5.4: Introduction of machine learning methods for predicting tax revenue
- Activity 2.5.5: Efficient system for calculation and payment of income tax for realized capital gains
- Activity 2.5.6: Efficient system for calculation and payment of income tax for interests from saving deposits

Priority results

The results of this priority are:

- Expanded tax base in relevant laws;
- Analysis for reduction of tax arrears;
- Reduced tax evasion;
- Implemented Registry of Beneficial Owners;
- Increased efficiency in supervision over the implementation of the AML/ CFT measures;
- Improved institutional capacity.

Indicators

- Increased PIT efficiency;
- Increased CIT efficiency;
- Increased VAT efficiency;
- Lower tax arrears;
- Established registry of beneficial owners;
- Increased number of conducted supervision over the implementation of the AML/CFT measures.
- Reduced shadow economy

Measure 2.1: Analysis for potential expansion of tax base

Objective of the measure

The end objective of this measure is to find possible ways to broaden the base on which taxes are applied, with the aim to increase tax revenues.

Background

All of the three main taxes in the Republic of North Macedonia have a tax base which is reduced in some way. The PIT has numerous tax deductions; the CIT has many revenues are exempt from taxation or some entities are released from CIT, while the VAT has many products and services that are taxed by the preferential VAT rate. All this reduces tax revenues.

To address this issue, the following activities will be undertaken.

Activity 2.1.1 Analysis of tax deductions in PIT

In PIT law, there are deductions prescribed in the form of “normed expenses”, which reduce the taxable base. In 2019 in the PIT law there were additionally put lower deductible expenses on every type of the incomes for example, on the income from sales of agricultural products, normed expenses are 80%, from income, from royalties they can be up to 50%, for rental income up to 15% and for capital gains up to 10%. Ministry of Finance will further analyze tax deductions in PIT and non-taxed income, in order to improve the tax base.

Activity 2.1.2. Analysis of the tax deductions in CIT

While the nominal CIT rate in the Republic of North Macedonia is 10%, the effective rate is lower due to existing tax deductions that are making the tax base lower. This reduces revenues and encourages companies to behave in ways that artificially decreases the tax base. In the following period the tax expenditures that are part from the CIT law and also tax incentives/ reliefs from CIT that are part of the other related laws (The law for State Aid, The law for control of the state aid, The law for technological industrial developed zones and etc.) will be subject for analyzing, in order to determinate the effective tax rate in CIT and to make correct estimations of the tax expenditures from CIT that reduced revenues from CIT in the budget.

Activity 2.1.3. Analysis of VAT preferential list

Besides the standard rate, the VAT has also a preferential rate. The range of goods and services to which the preferential rate is applied in the Republic of North Macedonia will be subject of reviewing in order to synchronize it with the recommendation in the VAT EU Directives.

Table 3.4 Implementation of the measure 2.1 - Analysis for potential expansion of tax base

Period for finalization	2023
Deliverables	Analysis of the PIT Law. Analysis of the CIT Law. Analysis of the VAT Law.
Costs	These activities will be implemented through regular working duties of employees of the relevant institutions. Total costs for salaries are estimated at 26,640 EUR.
Responsible body	MoF
Risks	Insufficient political will for implementing the changes. Insufficient support from stakeholders.

Measure 2.2: Reduction of tax arrears

Objective of the measure

The objective of this measure is to reduce tax arrears in the Republic of North Macedonia and to develop an effective system for prevention of their establishment in the future.

Background

Tax arrears in the Republic of North Macedonia amount to nearly 4.46% of GDP, which is approximately 16% of general government revenues. If tax arrears are to be reduced, this would generate additional revenues for provision of public goods.

Activity 2.2.1. Addressing tax arrears of SOEs

Many state-owned enterprises (SOEs) have sizeable amount of tax arrears. The reasons for that vary from case to case, but the most common are - moral hazard on the side of enterprises due to their nature ("too important to fail"), inefficient management, insufficient revenues due to structural problems etc. Collecting these tax arrears is further complicated by the notion that these enterprises often do not possess assets that can be confiscated nor can default, due to the public goods they have to provide. Therefore, a careful and thorough analysis is needed in order to devise measures for improving the situation.

Activity 2.2.2. Addressing accounts uncollectible and development of software for managing debt of taxpayers

Certain part of the debt that taxpayers have towards the MoF, PRO and CA is unpayable. Still, there are no clear data for the amount of this part, nor is there a strategy for managing it. To address this issue, certain changes in the legal framework will be done and special software will be developed, which will allow to get a complete picture of the age/maturity of debt, the flow of deadlines, and the real situation of total debt (i.e. separating real debts from uncollectible debt). After obtaining a complete picture of the state of debt, action plan for dealing with the situation will be developed.

Table 3.5 Implementation of the measure 2.2 - Reduction of tax arrears

Period for finalization	2023
Deliverables	Reduced tax arrears of SOEs. Functional software for the management of tax debt. Legal framework (Laws, bylaws…) for addressing unpayable debt.
Costs	100,000 EUR for software, 31,200 EUR for salaries of employees.
Responsible body	MoF, PRO, CA
Risks	Lack of will among officials. Insufficient human resources capacities. Delays due to technical difficulties.

Measure 2.3: Reduction of tax evasion

Objective of the measure

The objective of this measure is to reduce tax evasion by taking a series of activities targeting the reasons for creating the evasion and to overcome the weaknesses of the institutions directly responsible for combating tax evasion.

Background

Tax evasion remains a big problem in the Republic of North Macedonia. With “grey” economy estimated to be around 38% of GDP[12], revenue losses due to tax evasion are sizeable. Hence, a comprehensive set of measures is required to improve the situation.

Concretely, the following activities will be implemented.

Activity 2.3.1. Reduction of use of cash

The use of cash remains actual topic for debate in the Republic of North Macedonia. The increasing use of cash is a fertile ground for tax evasion. The maximum amount of cash that is allowed for using in the future period will be analyzed by the Ministry of Finance in order to address the right amount of cash allowed. To address this problem, a comprehensive set of actions targeted at cash reduction needs to be adopted by all relevant institutions. The Ministry of Finance, along with the Central Bank will create an updated action plan[13] for reduction of cash in the society. The Government, through the Ministry of Finance, is currently exploring possibilities for the implementation of a project named “Cashless Macedonia” to stimulate the use of cards as a means of payment and decrease the use of cash. This and other measures that come as a result of the analysis will be part of the action plan.

Activity 2.3.2. Improvement of fiscalization

Non-issuance of fiscal receipts by merchants remains a problem in the Republic of North Macedonia. It leaves the budget without revenues, leading further to insufficient investment in public goods and services. An all-encompassing action plan has been developed by the PRO to tackle this issue. A measure that has already been implemented by the PRO in close collaboration with the Ministry of Finance is the application “MyVAT” that ultimately aims to increase the number of merchants that issue fiscal receipts, either by their own volition or by active measures by the PRO acting on reports by the citizens using the application on a daily basis.

Additionally, the PRO will develop a software tool that would accurately track in appropriate time the revenues of the tax payer in order to monitor for deviations in recorded turnover and a more efficient way of tax audit. Furthermore, a new tool for virtual fiscalization will be developed aiming to connect and include the e-commerce sellers in the PRO system.

Activity 2.3.3. Improvement of VAT refund mechanisms to citizens

In order reduce the informal economy by improving collection of VAT and at the same time to improve the economic situation of households, all citizens above the age of 15 years have the right to claim 15% of the declared VAT in received fiscal bills issued for paid goods and services. This measure is implemented by introducing Law on VAT refund for citizens and the launch of a special mobile application “MyVAT” which is used for scanning and declaring VAT issued in fiscal bills. The app was launched in July 2019 and its implementation is currently monitored.

In order to improve the effectiveness of the measure, various upgrades were implemented, such as introducing gamification (game of chance) “MyVAT #MyPrize” as an additional motivation for the citizens to join the fight with the grey economy.

Additional features such as introducing a mechanism for donations of part of the collected refund amount via the mobile app will further be explored.

[12]IMF 2019 Article IV Mission Findings

[13] A strategy for reduction of cash with an action plan was created and published in 2018. An assessment and revision will follow along with creating a new action plan.

Activity 2.3.4. Accréditation of Customs laboratory

The accreditation of the Customs Laboratory in accordance with the EU standards aims to provide international recognition of the testing results that are performed in the Customs Laboratory, to reduce the need for repetition of procedures, and to allow easy flow of goods, services and passengers.

Activity 2.3.5. Improvement of risk prevention and management by PRO and CA

As a response to the increase in trade and travel, as well as the increase in the corresponding global uncertainty, Tax and Custom administrations are trying to implement a more structured and systematic way for preventing and managing risk.

To improve this, the existing risk assessment software will be upgraded in the PRO and the CA, in order to audit compliance of VAT, CIT, PIT, customs duties, excise duties and social contributions, to evaluate the risks involved, to define the risk environment, and through all this, to contribute to preventing risk build up, and ultimately improve the management of risk. This software shall be developed according to the experiences and the best international practices.

The software enables the automation of the risk analysis process, and will contribute to the improvement of the efficiency and cost-effectiveness of the external control procedures. In addition, it will eliminate the human factor from the whole process and will contribute for impartiality of the overall process.

Activity 2.3.6. Regulation of unregistered businesses

Currently, there is a lack of consistency in some of the provisions that regulate the unregistered activity, in the sense that unregistered entities are treated more favorably than entities that are registered but do not comply with tax regulations. This stimulates informality and aggravates tax evasion. Legal framework will be adjusted to address such a situation.

Activity 2.3.7. Preparing reports on trends in tax avoidance

In the current conditions of constant changes in the market economy, the problem of tax avoidance is becoming more important. The ways in which entities avoid paying taxes are transferred from one country to another with the same or similar tax system. Having in mind that the Republic of North Macedonia is a small open economy, it is very likely that these trends will be transferred and applied by domestic taxpayers, especially those that are part of multinationals companies. It is very important that the tax authorities are up to the new challenges so they can take appropriate actions when needed while also taking measures to strengthen their capacities.

Table 3.6 Implementation of the measure 2.3 - Reduction of tax evasion

Period for finalization	2023
Deliverables	Implemented action plan for appropriate limit of use of cash. Implemented action plan for improvement of fiscalization. Upgrades of the mobile app MyVAT with new features. Accredited customs laboratory. Improved software for risk management. Implemented amendments to the Tax Procedure Law. Implemented amendments to the Law on Registration of Cash Payments. Implemented amendments to other relevant laws. Regular reports on trends in tax avoidance.
Costs	535,000 EUR for technical equipment and software, 78,600 EUR for salaries of employees.
Responsible body	MoF, PRO, CA.
Risks	Insufficient human resources capacities. Delays due to technical difficulties. Unplanned additional expenses Insufficient political will

Measure 2.4: Addressing illicit financial flows

Objective of the measure

The objective of this measure is to address enablers of illicit financial flows and, through this, improve revenue collection.

Background

The term “Illicit financial flows” (IFFs) encompasses several different types of financial transfers that are made for different reasons, such as: funds with criminal origin, funds with a criminal destination, transfers intended to evade anti-money laundering/counter-terrorist financing measures or other legal requirements etc. IFFs constitute a major disabler to sustainable development. IFFs can have a direct impact on a country’s ability to raise, retain and mobilize its own resources for financing sustainable development.

Activity 2.4.1. Establishment of Registry of Beneficial Owners

In order to prevent legal entities from abuse for money laundering, financing of terrorism or illicit financial flows purposes, establishment of Register of Beneficial Owners (i.e. real owners) is foreseen, which will increase transparency of ownership and control structure of legal entities.

Fulfilling adequate, accurate and up-to-date information for the real owners of the legal entities is the basic function of the registry, which can provide correct information in real time, and also to provide legal certainty in establishing business relationships within the business society.

The Registry of Beneficial Owners is provided with the Law for Prevention of Money Laundering and Financing of the Terrorism, the establishment, management and maintenance of which is entrusted to the Central Registry, and in cooperation with the Financial Intelligence Office has the priority - to help to prevent money laundering and financing terrorism.

Activity 2.4.2. Increasing efficiency of measures for detection of illicit financial flows

Proper implementation of Customer Due Diligence (CDD) measures by entities obliged to undertake anti money laundering (AML) and combating of financing of terrorism (CFT) actions will enable efficient detection of IFF and adequate reaction by competent authorities. Strengthening AML/CFT supervisory regime will contribute for efficient enforcement of CDD rules.

Table 3.7 Implementation of the measure 2.4. Addressing illicit financial flows

Period for finalization	2023
Deliverables	Implemented new Law on AML/CFT. Operational Register of Beneficial Owners. Increased number of implemented AML/CFT measures.
Costs	No direct costs, an ongoing Project against economic crime will facilitate the implementation of the activities from the Action Plan of the AML/CFT National Strategy. Estimated costs for salaries of employees are 46,000 EUR.
Responsible body	FIO
Risks	Insufficient institutional capacities.

Measure 2.5: Improving capacities of institutions of the tax system

Objective of the measure

The objective of this measure is to support the development of the tax-related institutions, by increasing their capacity for program implementation, while reducing operating costs and creating staff capable for implementing the technical and technological modernization.

Background

Tax-related institutions need to be improved both in terms of technology and in terms of human resources. This will strengthen their capacity and will result in an efficient structure for governing and managing changes.

Activity 2.5.1. Human resources development

Human resources are vital for the success of the organization. In this direction, the relevant institutions should bear in mind the professional development of their staff. This means that the tax and customs professionals should have the required knowledge and skills in order to provide an efficiency of the operations and modernization of the services. To achieve this, both IT system and staff training is required.

Activity 2.5.2. Improvement of non-intrusive equipment of CA

The main efforts of the tax and customs organizations should be focused on the simplification of the tax and customs procedures, including those for declaring, control and payment, with the purpose to reduce the administrative procedures and costs. When customs administration is concerned, the crucial component in this respect is the modern technical control equipment, which improves the performance of the customs control, which is very important in the context of the constant increase in the illegal movement of goods, vehicles and passengers.

Activity 2.5.3. New integrated IT system of PRO

The current information system of the Public Revenue Office is outdated and the basic business processes are incomplete and fragmented, with separate solutions for different business areas. It cannot provide reliable and clear data related to taxpayer records in real time. This leads to potential risks of the integrity of the services and increases the volume of data that should be managed manually by the employees.

To address this, a new integrated IT system that covers all business processes and ensures data records in accordance with the national and international regulations and standards will be introduced, based on the model developed previously with EU support. It will result in quality services for all users, and will contribute to revenue growth and reduction of the tax burden.

Activity 2.5.4. Introduction of machine learning methods for predicting tax revenue

The main characteristic of this approach is that machine learning algorithms are trained rather than explicitly programmed, so they can learn complex patterns automatically based on provided data. Nowadays in the era of digitization this feature of machine learning algorithms can give us big advantage in comparison with statistical modeling or other approach for prediction revenues. In order to provide superior results in comparison with other algorithms, machine learning algorithms often use ensemble techniques where they combine models. Accurate estimation of tax revenue means and better liquidity in Central Budget and also funds for different budgetary needs.

Activity 2.5.5. Efficient system for calculation and payment of income tax for realized capital gains

Taxation of capital gains is postponed until the end of 2022. Personal income tax for this type of income shall be taxed after deduction, i.e. income payer shall calculate, withheld and pay the tax for the taxpayer. Before starting the taxation of capital gains generated from sale of securities, all parties involved - the Macedonian Stock Exchange, the Securities and Exchange Commission and the Central Securities Depositary, shall be engaged in building an electronically connected system that will ensure efficient calculation and payment of income tax on the realized capital gains from selling the securities.

Activity 2.5.6. Efficient system for calculation and payment of income tax for interests from saving deposits

Taxation the interests on saving deposits is postponed till the end of 2022. The tax of this type of income will be withheld by the payer of the income. Before the taxation of the interests of saving deposits began, the banking sector will adjust their system of calculating the interest, in order to calculate and pay personal income tax on interest on saving deposits more quickly and efficiently.

Table 3.8 Implementation of the measure 2.5. Improving capacities of institutions of the tax system

Period for finalization	2023
Deliverables	Functional HR management software. Implemented Competency Development Training Program. Functional non-intrusive equipment of CA. Functional IT system of PRO. Functional machine learning models in MoF Functional electronically connected system for taxation of capital gains. Functional system for taxation the income on the interest from saving deposits
Costs	13 million EUR for technical equipment and software, 249,600 EUR for salaries of employees.
Responsible body	MoF, PRO, CA, FIO, FP, MSE, SEC, CSD.
Risks	Insufficient human and institutional capacities. Delays due to technical difficulties. Lack of finances. Resistance to change and insufficient commitment from employees.

3.3 Priority 3: Increase Tax Transparency

Objective

The objective of this priority is to improve the exchange of information of the tax authorities with other entities, as well as to improve the overall transparency of tax matters, including improvements through e-services, which are elaborated in greater detail under the next priority.

This objective will be achieved through the following measures and activities:

Measure 3.1: Improving exchange of information

- Activity 3.1.1: Introduction of OECD Common Reporting Standard
- Activity 3.1.2: Introduction of System for Exchange of Excise Data
- Activity 3.1.3: Acceding to EU conventions for exchange of information (Naples 2)

Measure 3.2: Increasing availability and quality of tax-related information

- Activity 3.2.1: Organizing trainings for taxpayers on important legislative changes
- Activity 3.2.2: Publication of informational materials on important legislative changes
- Activity 3.2.3: Publication of reports and data on taxes
- Activity 3.2.4: Publication of reports of international organizations on tax matters

Priority results

- Improved exchange of information;
- Enhanced fiscal/tax literacy;
- Improved voluntary compliance.

Indicators

- Introduced OECD common reporting standard;
- Ratified EU conventions for exchange of information (Naples 2);
- Introduced System for Exchange of Excise Data;
- Organized training for taxpayers;
- Published informational materials and reports.

Measure 3.1: Improving exchange of Information

Objective of the measure

The objective of this measure is to significantly improve and facilitate tax cooperation with other tax administrations through the implementation of international tax standards and other instruments, as well as to improve the ability of the tax authorities to deter, detect and disrupt tax evasion and avoidance.

Background

Exchange of information is about achieving global tax co-operation through the implementation of international tax standards and other instruments to put an end to bank secrecy and tackle tax evasion.

Activity 3.1.1. Introduction of OECD Common Reporting Standard

The OECD Common Reporting Standard (CRS) is the single global standard for the collection, reporting and exchange of financial account information on foreign tax residents. Banks and other financial institutions will collect and report to our tax administration financial account information on non-residents using the standard. The adoption of this standard will contribute to the exchange of information with foreign tax authorities of non-residents. In parallel, the tax administration will receive financial account information on Macedonian residents from other countries' tax authorities. This will help ensure that Macedonian residents with financial accounts in other countries comply with our tax law and deter tax evasion.

Activity 3.1.2. Introduction of System for Exchange of Excise Data

System for Exchange of Excise Data (SEED) is an online service which allows verifying excise numbers through a standard web browser. It is intended for companies, so that they would be able to check the validity of an excise number. Introduction of SEED will ease the administrative burden for companies.

Activity 3.1.3. Acceding to EU conventions for exchange of information (Naples 2)

The abolition of administrative procedures on crossing the internal frontiers of the European Union heightens the risk of fraud, if all the Contracting Parties do not apply equivalent control measures. Administrative cooperation must encourage a comparative level of checks, thus ensuring the uniform application of the European law at every point of the EU external borders and guaranteeing mutual trust and equal conditions of competition. The efficiency of a customs union depends, indeed, as much on homogeneous rules as on the quality of its operational structures.

The **Naples II Convention** on Mutual Assistance and Cooperation between Customs Administrations aims to crack down on the proliferation of illicit trafficking in breach of national and European provisions by making customs cooperation faster and more effective. The aim of the joint automated information system for customs purposes is to assist in preventing, investigating and prosecuting serious contraventions of national laws by making information available more rapidly, thereby increasing the effectiveness of the cooperation and control procedures of the customs administrations of the Member States.

Table 3.9 Implementation of the measure 3.1. Improving exchange of Information

Period for finalization	2023
Deliverables	Implemented OECD common reporting standard. Implemented System for Exchange of Excise Data. Implemented Naples 2.
Costs	500,000 EUR for technical equipment and software, 42,240 EUR for salaries of employees.
Responsible body	MoF, CA, PRO
Risks	Failure to receive expert technical assistance. Insufficient administrative and human resources capacities.

Measure 3.2: Increasing availability and quality of tax-related information

Objective of the measure

The main objective of this measure is to increase the voluntary compliance of taxpayers by increasing the transparency and strengthening the trust taxpayers have in the relevant institutions.

Background

According to the best international practices, one of the main objectives of the relevant institutions is to strive to achieve a high level of voluntary compliance, that is, for taxpayers to voluntarily fulfil their tax obligations.

This goal is achieved through a range of activities aimed at providing easy access to tax information, education of taxpayers and public disclosure of information about the work of the relevant institutions.

The increase in voluntary compliance not only increases the efficiency and effectiveness of the competent institutions, but also increases the confidence of citizens and companies in tax authorities.

Activity 3.2.1. Organizing training for taxpayers on important legislative changes

A key mechanism for increasing voluntary compliance is timely informing and educating taxpayers. In this context, tax authorities should have an annual plan for education of taxpayers, under which training should be organized for different categories of taxpayers (farmers, craftsmen, newly registered taxpayers, etc.). This activity will be implemented through the PFM School which will be established under the PFM Reform Program.

Activity 3.2.2. Publication of informational materials on important legislative changes

To ensure that taxpayers are well informed about the need and effects of the changes in tax legislation, it is a good practice to start publishing informational materials whenever some important change is implemented. The informational materials such as leaflets, infographics, videos and brochures, are much easier to understand for the general public than the laws themselves, and also have educational and awareness-raising component in themselves. This activity will be implemented by adopting a rule that for each important legislative change, a set of informational materials should be published.

Activity 3.2.3. Publication of reports and data on taxes

Taxpayers should know all the relevant information on taxes, since it is their money in question. This includes information on tax collection, effective tax rates, distribution of taxes by various criteria (location, size of taxpayer etc.), estimates of tax expenditures (i.e. foregone taxes due to tax exemptions) etc.

Activity 3.2.4. Publication of reports of international organizations on tax matters

Many international organizations publish reports on tax matters that are relevant for Macedonia, which contain valuable information, for the general public, for students, for researchers, for journalists, for taxpayers. Moreover, reports from international organizations provide an objective perspective on the situation and the developments of relevant institutions. However, these reports are scattered on different web-sites, so it is often difficult to obtain the required information. To address this, it is envisaged that all relevant reports from international organizations will be published on the web-site of the Ministry of Finance, where the public can easily access them.

Table 3.10 Implementation of the measure 3.2. Increasing availability and quality of tax-related information

Period for finalization	2021
Deliverables	Organized training for taxpayers Published materials Published reports
Costs	30,000 EUR for design of materials and printing, 15,000 for organizing trainings, 47,520 for salaries of employees.
Responsible body	MoF, PRO, CA
Risks	Insufficient human and institutional capacities. Failure to prepare materials on time.

3.4 Priority 4: Improve quality of services

Objective

The objective of this priority is to improve the quality of services that the taxpayers receive from the tax authorities in order to increase the economic feasibility of the procedures, to simplify and speed up the procedures and to reduce the administrative burden of the procedures.

Measure 4.1: Improving services for citizens and companies

- Activity 4.1.1: Expansion of e-services
- Activity 4.1.2: Modernization of call center services
- Activity 4.1.3: Introduction of paperless customs environment
- Activity 4.1.4: Introduction of a single window for companies at borders

Measure 4.2: Improving control mechanisms

- Activity 4.2.1: Introduction of Diagnostic Control Systems
- Activity 4.2.2: Support for introducing Tax Control Framework
- Activity 4.2.3: Improvement of internal control and audit in tax institutions

- Activity 4.2.4: Strengthening capacities for tax audit

Priority results

- Digitized services;
- Improved management of issuance of import-export licenses;
- Elimination of unnecessary non-tariff barriers in foreign trade activities;
- Improved internal control and tax audit.

Indicators

- Upgrade of system for pre-filled PIT returns for citizens;
- Increased percentage of digitized services;
- Shortened time for paying taxes;
- Improved distance to frontier of Trading Across Borders indicator;
- Increased number of tax auditors.

Measure 4.1. Improving services for citizens and companies

Objective of the measure

The objective of this measure is to improve the quality and efficiency of service delivery through a wide-range of initiatives designed to increase service coverage to taxpayers and to implement new and improved business processes.

Background

Tax authorities serve the taxpayers and should therefore offer them the best possible experience. In order to do that, tax authorities should identify cost efficient methods of service delivery and utilize resources more efficiently. They should determine which resource-intensive programs can be automated; they should identify new taxpayer self-service applications and provide fully automated services through multiple media. Activities under this measure are closely related to activity 2.5.3, which refers to the introduction of a new PRO IT system.

Activity 4.1.1. Expansion of e-services

Taxpayers are continually looking for self-service options to interact with tax authorities. To address this, enhanced filing and payment programs will be launched.

Main aspects to be covered here include upgrading pre-filled PIT return form for citizens, inclusion improving ease of use and user-friendliness; receiving in real time companies' tax data, instead of having the companies submitting them annually at the end of the year; expanding online services in order to allow submission of various requests for tax issues; expanding online services in order to allow obtaining various reports and documents; exploring the possibility of introducing new e-services such as e-accounting etc.

Activity 4.1.2. Modernization of call center services

By expanding call center services, it becomes easier for taxpayers to receive required information, while at the same time it becomes cheaper for tax authorities to provide that information. New services in the Contact Center will be developed and introduced through the establishment of a new working environment, procurement of new equipment and improvement of business processes in the Public Revenue Office.

In addition, the existing system of tax counters will be reorganized in the direction of achieving greater economy and effectiveness, reducing the number of static tax counters and replacing them by a smaller number of mobile tax counters. Special emphasis will be put on choosing the regions where the mobile tax counters will be put, focusing on regions where direct contacts with the individuals is most required.

Activity 4.1.3. Introduction of paperless customs environment

In order to provide paperless environment in the customs work, the Customs Administration of the Republic of North Macedonia started the implementation of a new Customs Declaration and Excise Documents Processing System (CDEPS). The overall objective of the CDEPS project is to provide a system that will allow seamless flow of electronic information between all actors involved, greatly improving in that way the quality of the service for companies.

Activity 4.1.4. Introduction of a single window for companies at borders

A Single Window Environment is a cross border 'intelligent' facility that allows parties involved in trade and transport to lodge standardized information, mainly electronic, with a single-entry point to fulfill all import, export and transit related regulatory requirements. The establishment of the Single Window Environment is considered to be the solution for the complex problems of border automation and information management involving multiple cross border regulatory agencies. For this activity, the World Bank Project for Single Window shall be supported for the introduction of this system

Table 3.11 Implementation of the measure 4.1. Improving services for citizens and companies

Period for finalization	2023
Deliverables	Implemented upgrades to the pre-filled PIT returns for citizens. Increased number of online tax services. Increased number of call tax services. Implemented Customs Declaration and Excise Documents Processing System (CDEPS). Implemented Single Window Environment.
Costs	2,108,000 EUR for technical equipment and software, 211,200 EUR for salaries of employees.
Responsible body	PRO, CA
Risks	Insufficient human capacities. Lack of technical knowledge for project implementation. Delays due to technical difficulties.

Measure 4.2: Improving control mechanisms

Objective of the measure

The objective of this measure is to improve the mechanisms that control the work of the tax institutions, as well as the mechanisms that ensure compliance of companies to tax legislation, and through this, to improve the overall work of the tax institutions and the cooperation between companies and tax authorities.

Background

All revenue authorities are generally required to achieve as good a compliance outcome as possible (i.e., to maximize the overall level of compliance with the tax laws). For this purpose, they are appropriated a finite level of resources, meaning that careful decisions are required as to how and in what ways those resources are to be applied to achieve the best possible outcome in terms of improved compliance with the tax laws. Directly related to this issue is the critical matter of deciding the priorities for compliance action and the specific actions to be taken.

In practice, there are many factors that complicate answering these important questions (e.g., the diversity of taxpayers' compliance behaviors, a lack of knowledge concerning the nature and incidence of non-compliance across the different segments of taxpayers, and the complexity of many taxpayers' tax affairs). For these sorts of reasons, revenue bodies require a systematic process for deciding what is important in a tax compliance context and how major compliance risks will be addressed.

Activity 4.2.1. Introduction of Diagnostic Control System

The Diagnostic Control System (DCS) is the formal system of information that one organization has for monitoring results and correcting deviations from expected performance standards. It seeks to ensure that decisions align with the goals of the organization. The key unit in this regard is the internal control department. The key factors that should be considered here are the costs for auditing/controlling and the way in which errors are dealt with.

Activity 4.2.2. Support for introducing Tax Control Framework

Companies need tax control framework (TCF) in order to ensure accuracy and completeness of their tax returns and the other disclosures made to the tax authorities. TCF are not very common in North Macedonia, but they could become very useful because they could improve compliance by companies, and through this, lead to better cooperation between companies and tax institutions.

Activity 4.2.3. Improvement of internal control and audit in tax institutions

New methodological tools and legal framework on internal control (financial management and control and internal audit) developed by MoF should be implemented efficiently by tax authorities. Therefore, the capacities of the relevant internal audit and financial control departments should be enhanced.

Activity 4.2.4. Strengthening capacities for tax audit

The number of tax auditors is constantly declining in recent years, and is currently around 15% of the total number of employees in the PRO, compared to 2006 when it was 25% of the total number of employees. Moreover, the age structure of the auditors is worsening, with increasing number of tax auditors reaching the retirement age every year. Periods necessary for training new staff in the tax audit function are long, and there is a lack of specialized guidelines and system training for new staff.

Table 3.12 Implementation of the measure 4.2. Improving control mechanisms

Period for finalization	2023
Deliverables	Increased Tax compliance. Introduced Diagnostic Control System. Implemented Tax Control Framework. Improved internal control. Improved tax audit.
Costs	100,000 EUR for technical assistance, 528,800 EUR for salaries of employees, 20,000 EUR for preparation of new guidelines and trainings.
Responsible body	PRO, CA, MoF, FIO, FP
Risks	Insufficient human capacities. Lack of technical knowledge for project implementation. Delays due to technical difficulties

3.5 Priority 5: Introduce Green Taxation

Objective

The objective of this priority is to improve legal arrangements regarding green taxation in the Republic of North Macedonia, as well as their implementation, with a final purpose to reduce pollution. Its primary goal is not to increase fiscal income: green taxation is meant to set up a "smarter" taxation, with a shift from a labor to a pollution tax base, yielding environmental, social and economic benefits. The objective is to be in line with the New Strategic Agenda for 2019-2024 of the European Union, setting as one of its four priorities to build a climate-neutral, green, fair and social Europe, as well as with the priorities outlined in the Green New Deal, the on-going 7th Environmental Action program ('EAP') and the Council conclusions on upcoming the 8th EAP.

Measure 5.1: Introduction of incentives for environmental responsibility

> Activity 5.1.1: Assessment of legal framework and drafting proposals for introduction of incentives for environmental responsibility

Measure 5.2: Introduce framework for environmental taxation

> Activity 5.2.1: Assessment of legal framework and drafting proposals for the introduction of environmental taxation

> Activity 5.2.2: Monitoring of the implementation of the new Regulation for new Law on Motor Vehicles Tax and defining the CO2 component.

Priority results

> Reduced pollution;

> Protected natural resources;

> Increased revenues from environmental taxes.

Indicators

- Established framework for environmental taxation;
- Communal fees related to pollution;
- Duties on pollutants;
- Motor Vehicles Tax based on CO2 emissions;
- Lowering custom tariffs for environmentally-friendly products.

Measure 5.1. Introduction of incentives for environmental responsibility

Objective of the measure

The purpose of this measure is to raise both households' and companies' environmental awareness and promote good practices through fiscal incentives, with the aim of promoting a better use and allocation of resources.

Background

Social and environmental adverse side-effects of production, consumption and investment decisions are generally not fully factored in by individuals and companies when making choices, as they rarely materialize in immediate monetary costs. This well-known type of market failure can be tackled through both fiscal and regulatory measures, aiming at making transaction prices better incorporate negative externalities. Improved transparency through enhanced reporting standards reflecting companies' decisions environmental costs is also a powerful tool to guarantee stakeholders' accountability. The Republic of North Macedonia is committed to create and implement an appropriate set of "market signals" as outlined in the European Union 7th Environmental Action Program 2020.

Activity 5.1.1. Assessment of legal framework and drafting proposals for introduction of incentives for environmental responsibility

Despite their potential budgetary cost, fiscal incentives to households and companies can be an effective tool in the context of some production, consumption and investment decisions. This activity would assess the potential introduction of such incentives in specific laws, such as the Motor Vehicles Tax Law, Law on Custom Tariffs, etc. Examples of incentives implemented in other EU countries include tax refund or tax credit for green expenses and investments done by households and/or corporates. These incentives may impact respectively PIT and CIT revenues. Besides, consistently with the EU Agenda strategy, which links social and green policies, these incentives may also pursue redistribution objectives and be targeted on low income households for instance[14].

[14] Environmental taxation and EU environmental policies, EEA Report N° 17/2016

Table 3.13 Implementation of the measure 5.1. Introduction of incentives for environmental responsibility

Period for finalization	2023
Deliverables	Implemented new Law on Motor Vehicles Tax. Analysis for amendments in the Law on Custom Tariffs.
Costs	These activities will be implemented through regular working duties of employees of the relevant institutions. Total costs for salaries of employees are estimated at 16,320 EUR.
Responsible body	MoF and CA.
Risks	Insufficient knowledge on the issue. Insufficient interest from stakeholders.

Measure 5.2: Introduce framework for environmental taxation

Objective of the measure

Pollution taxation charges polluters for the negative impact their actions cause to the environment and others. Such taxes reduce environmental harm in the least costly way, by encouraging behavior that reduce pollution. Pollution taxation is not primarily about higher taxes, but about smarter taxes. They are considered to be more effective than regulation at reducing pollution and can generate significant environmental benefits. Green taxation also contributes to shift taxation from labor to pollution, in line with EU's policies, and hence yield economic benefits. Overall the main priority of this measure is to ensure that taxation is aligned with climate objectives.

Background

Given the reality of climate change, an effective and efficient fiscal system must reduce pollution and environmental damage. A variety of policy measures can be used towards this end, and taxes are considered to be amongst the most effective in this respect. Their distinguishing feature is that the final decisions are left with the producers and consumers, while the role of government is to set the appropriate level of tax, affecting in that way the final price. By taxing substances which harm the environment, pollution taxation reduces the incentive for producers and consumers to use them. The result will be lower levels of pollution.

With the new Law on Tax on Motor Vehicles is introduces an environmental component that should influence on the environmental awareness of the citizens and stimulate them to use greener vehicles (that pollute less) and which will contribute to a healthier environment and reduce air pollution.

The subject of taxation with excises with the new Law on Excises are also energy product which are segment that affects the environmental pollution.

It is to be noted that environmental taxation has been gaining momentum over the last decade in Europe, and in particular in North Macedonia's regional peer countries which now rely more heavily on such measures than European Union average. Environmental tax revenues range indeed from 3.0% of GDP in Bulgaria to 3.9% in Serbia against an average of 2.4% in the European Union[15], and from 9.3% of total revenues and social contributions in Croatia to 11.4% in Serbia against a European Union average of 6.1%.

[15] "Environmental tax statistics", Eurostat, January 2019

Three types of environmental taxes are generally distinguished: energy taxes[16], transport taxes[17] and taxes targeting pollution and resources[18]. Countries rely mostly on environmental taxes on energy (European Union average of 77.1% of environmental tax revenues), and more marginally on transport (19.7%), and pollution and resources (3.2%). Among regional peers, Serbia stands out as a country where taxes targeting pollution and resources are used the most (6.6% of total environmental tax revenues).

The impact on taxpayers vary depending on the type of taxed economic activity. On average, energy taxes are almost evenly paid by companies (European Union average of 51% of total energy tax revenues in 2016) and households (47%), while households pay more transportation taxes (European Union average of 65% of total transport tax revenues in 2016) than companies (33%).

Table 3.14 Environmental tax contributions in 2018

	EU Average	Bulgaria	Croatia	Greece	Serbia[1]	Slovenia
Share of GDP	2.4%	2.9%	3.6%	3.7%	4.1%	3.5%
Share of total revenues and social contributions	6.1%	9.8%	9.3%	9.5%	11.4%	9.4%
Share of energy tax in environmental tax revenues	77.1%	87.4%	76.9%	78.4%	86.7%	84.1%
Share of transport tax in environmental tax revenues	19.6%	10.5%	22.6%	21.4%	6.8%	12.5%
Share of pollution /resources tax in env. tax revenues	3.3%	2.0%	0.6%	0.3%	6.6%	3.4%

Source: Eurostat
Note: Last data available for Serbia is 2016

Activity 5.2.1. Assessment of legal framework and drafting proposals for the improvement of environmental taxation

This activity envisages analyzing current legal arrangements on pollution taxation and drafting proposals for their improvement. This includes assessment of the Excise Law, amendments to the Law on Communal Fees and improvement of the new Law on Vehicle Tax. In addition, analysis for implementation of taxation of certain products and services that are not currently taxed, such as certain types of energy, as well as changing the way of taxation of certain products, such as vehicles, towards taxation based on CO2 emissions will be conducted. To be fully comprehensive, the assessment may take into account the impact on the overall tax burden for taxpayers, and envisage the consequences tax reductions to compensate the

[16] Energy environmental taxes are implemented by all European Union countries, in particular on fuel used both on transportation and stationary purposes (mostly heating and electricity production) (Source: "Environmental taxation and EU environmental policies", European Environmental Agency, 2016)
[17] Transport environmental taxes are widely implemented by European Union countries. Taxes based on the sale, registration and use of motor vehicles are used by almost all members. Italy, Malta, Sweden and the United Kingdom stand out as having implemented congestion charges in some cities (Source: "Environmental taxation and EU environmental policies", European Environmental Agency, 2016)
[18] Pollution and resources targeted environmental taxes include a broad range of measures. The main fields are water production, waste management (landfill and incineration), air pollution and land pollution (pesticides and fertilizers as well as mineral extraction). Landfill and water production taxation are the most popular measures among European Union countries (Source: "Environmental taxation and EU environmental policies", European Environmental Agency, 2016)

higher green taxation, in particular for low income households[19]. It could also consider the opportunity of earmarking the additional revenues specifically to green projects[20].

Activity 5.2.2: Monitoring of the Implementation of the new Regulation for new Law on Motor Vehicles Tax and defining the CO2 component

The calculation of motor vehicle tax consists of two components: The Ad Valorem component that implies taxation of a percentage of the value of the vehicle and the Specific component whereby the calculation is made using carbon dioxide emission data for CO2 vehicles. In this way, environmentally-friendly vehicles with lower CO2 emissions become more economically viable to procure than those with higher CO2 emissions.

The Law on Motor Vehicle Tax should bring environmental benefits aiming to reduce ambient air pollution by rebuilding the fleet while incentivizing the purchase of greener vehicles with low or "0" carbon dioxide emissions - CO2 as a result of lower fuel taxation.

The new Law on Motor Vehicle Taxation is in line with the European Union's recommendations[21] for the introduction of an environmental component in the taxation of vehicles with a view to reducing global environmental pollution and to ensure that the price of transport reflects the impact they have on the environment, as outlined in the Green New Deal of the European Union[22]. The new measures may also draw on the experiences from other countries such as the vehicle taxation scheme implemented in Denmark or in the Netherlands[23].

Table 3.15 *Implementation of the measure 5.2. Introduce framework for environmental taxation*

Period for finalization	2023
Deliverables	Introduced framework for environmental taxation Implemented New Excise Law. Implemented new Law on Motor Vehicles Tax. Implemented amendments in the Law on Communal Fees. Monitoring of the implementation of the Regulation for new Law on Motor Vehicles Tax
Costs	These activities will be implemented through regular working duties of employees of the relevant institutions. Total costs for salaries of employees are estimated at 24,600 EUR.
Responsible body	MoF and CA.
Risks	Insufficient knowledge on the issue. Delays due to technical difficulties. Insufficient support from stakeholders.

[19] Sweden is a relevant precedent to consider. The country implemented a carbon tax scheme in the early 1990s by reducing existing excise taxes to maintain the overall level of the tax burden for households and service, while introducing special tax rules for energy-intensive industries (Source: *Environmental taxation and EU environmental policies*, European Environment Agency, 2016)
[20] Several countries have implemented tax surcharge schemes on specific products or activities to generate funds for renewable energy production. Relevant benchmarks to consider are Netherlands (targeting gas and electricity since 2013) or Slovenia (all energy products).
[21] Communication From The Commission To The European Parliament, The Council And The European Economic And Social Committee Strengthening The Single Market By Removing Cross-Border Tax Obstacles For Passenger Cars Brussels, 14.12.2012 COM (2012) 756 final
[22] *The European Green New Deal*, Communication from the Commission to the European Parliament, the European Council, the Council, the European economic and social committee and the Committee of the regions, COM(2019) 640 final, December 2019
[23] Both countries have implemented tax scheme focused on vehicle purchase and registration varying according to vehicle's carbon efficiency and are considered as having been effective in reducing vehicles-related carbon emissions. Nevertheless, these measures proved costly as fiscal income fell significantly – by 65% in the Netherlands and 46% in Denmark (Source: *Environmental taxation and EU environmental policies*, European Environment Agency, 2016)

4. MONITORING AND REPORTING OF THE IMPLEMENTATION OF THE STRATEGY

The process of planned monitoring and reporting of the implementation of the Strategy is shown below.

The Tax System Reform Strategy Working Group (TSRS WG) will conduct regular quarterly meetings, in order to coordinate the activities. It will also monitor implementation and prepare the required annual reports. After the preparation of the reports, TSRS WG will submit them to the Public Financial Management Sector Working Group (PFM SWG).

Annual reports will be prepared by the end of the first quarter each year for the previous year and will be submitted to the Minister of Finance and PFM SWG.

The PFM SWG will submit the reports to the PFM Council. If there are objections, it will return the reports to the TSRS WG, with specific comments on what should be improved.

PFM Council will discuss the reports, alongside with the other reports, will approve them and will then submit them to the Government, which will adopt them.

Mid-term review of the Strategy will be done in 2021, by the TSRS WG, taking into account progress in implementation of the TSRS and the PFM Reform Program, as well as changes in circumstances.

Civil Society Organizations and academia will be included in the process, too, through their participation in the TSRS WG and PFM SWG.

Government of the Republic of Macedonia
Adopts reports

PFM Council (chaired by Minister of Finance)
Discusses reports, approves them and submits them to the Government

PFM SWG (chaired by Head of PFM SWG)
Reviews reports, ensures consistency with PFM reports and submits them to PFM Council

TSRS WG (chaired by Coordinator of TSRS WG)
Coordinates actions, monitors implementation and prepares reports. Holds regular meetings every quarter.

5. FINANCING OF THE STRATEGY

The Tax System Reform Strategy will be funded through three sources: national contribution, grants from international donors and credits.

Funds under **national contribution** will be provided by the Government of the Republic of North Macedonia, through the state annual budget, per respective institutions, in accordance with the planned dynamics for the implementation of the activities.

Grants from international donors will primarily come through capacity development projects or technical assistance. This mainly concerns EU donations under the Instrument for Pre-Accession. In addition, the EU may grant resources under budget support to Macedonia, indirectly contributing to this effort.

Activity 4.1.4. Introduction of a single window for companies at borders that allows parties involved in trade and transport to lodge standardized information, mainly electronic, will be financed by a **loan** from a World Bank.

The table below provides a synopsis of the known estimated costs for the strategy at the time of preparation of this document. The Strategy is estimated to cost 18,985,420 EUR, of which 10,050,000 EUR will come as grants from international donors, 7,785,420 EUR will be allocated under the state budget, including the credit of 700,000 EUR from the World Bank. Considerable funds supporting the implementation of the Strategy are already programmed under IPA 2018.

Table 5.1 **Financing of the strategy**

Priority	Measure	Total costs (euros)	National contribution (euros)	Grants from international donors (euros)	Credit (euros)
1.Increase fairness of taxation		**1,375,300**	**365,300**	**1,010,000**	**-**
	1.1. Review existing tax policy and introduce improvements	21,300	21,300	-	-
	MoF	14,100	14,100	-	-
	PRO	7,200	7,200	-	-
	1.2. Ensuring fair competition	51,600	41,600	10,000	-
	MoF	42,960	32,960	10,000	-
	PRO	8,640	8,640	-	-
	1.3. Harmonization with EU and best practices	1,302,400	302,400	1,000,000	-
	MoF	1,151,200	151,200	1,000,000	-
	CA	50,400	50,400	-	-
	PRO	100,800	100,800	-	-
2. Improved efficiency and productivity of the tax system		**13,981,440**	**5,621,440**	**8,360,000**	**-**
	2.1. Analysis for potential expansion of tax base	26,640	26,640	-	-
	MoF	15,120	15,120	-	-
	PRO	11,520	11,520	-	-
	2.2. Reduction of tax arrears	131,200	131,200	-	-
	MoF	7,200	7,200	-	-
	PRO	114,400	114,400	-	-
	CA	9,600	9,600	-	-
	2.3. Reduction of tax evasion	526,000	166,000	360,000	-
	MoF	18,000	18,000	-	-
	PRO	384,000	24,000	360,000	-
	CA	124,000	124,000	-	-
	2.4. Addressing illicit financial flows	48,000	48,000	-	-
	FIO	48,000	48,000	-	-
	2.5. Improving capacities of institutions of the tax system	13,249,600	5,249,600	8,000,000	-
	PRO	11,172,800	5,172,800	6,000,000	-
	CA	2,019,200	19,200	2,000,000	-
	MoF	19,200	19,200	-	-
	FIO	19,200	19,200	-	-
	FP	19,200	19,200	-	-
3. Increase Tax Transparency		**619,760**	**119,760**	**500,000**	**-**
	3.1. Improving exchange of information	542,240	42,240	500,000	-
	MoF	14,400	14,400	-	-
	PRO	19,200	19,200	-	-
	CA	508,640	8,640	500,000	-
	3.2. Increasing availability and quality of tax-related information	77,520	77,520	-	-
	MoF	22,960	22,960	-	-
	PRO	27,280	27,280	-	-
	CA	27,280	27,280	-	-

4. Improved quality of services		**2,968,000**	**1,638,000**	**630,000**	**700,000**
	4.1. Improving services for citizens and companies	2,319,200	1,089,200	530,000	700,000
	PRO	549,200	19,200	530,000	-
	CA	1,770,000	1,070,000	-	700,000
	4.2. Improving control mechanisms	648,800	548,800	100,000	-
	PRO	511,680	511,680	-	-
	CA	11,680	11,680	-	-
	MoF	109,760	9,760	100,000	-
	FIO	7,840	7,840	-	-
	FP	7,840	7,840	-	-
5. Introduce Green Taxation		**40,920**	**40,920**	**-**	**-**
	5.1. Introduction of incentives for environmental responsibility	16,320	16,320	-	-
	MoF	8,640	8,640	-	-
	CA	7,680	7,680	-	-
	5.2. Introduce framework for environmental taxation	24,600	24,600	-	-
	MoF	12,600	12,600	-	-
	CA	12,000	12,000	-	-
Total		**18,985,420**	**7,785,420**	**10,500,000**	**700,000**

6. PERFORMANCE ASSESSMENT FRAMEWORK OF THE STRATEGY

The Performance Assessment Framework (PAF), which provides grounds for measuring the implementation of the Strategy, is shown below. For each of the indicators stated above in the Strategy, the PAF provides the baseline values as of 2017, and the targeted values for 2019 and 2021. The PAF also provides the data sources for measuring the indicators.

6.1 Priority 1: Increase Fairness of Taxation

Table 6.1 Increase Fairness of Taxation

Indicators	Data sources	Baseline (2018)	Mid-term (2021)	Target (2023)
Reduced inequality of income distribution, S80/S20 %	MoF	6.2% in total individual post-tax income	6.1% in total individual post-tax income	6.0% in total individual post-tax income
Increased PIT revenues;	MoF	2.70% of GDP	2.75% of GDP	2.80% of GDP
Increased CIT revenues;	MoF	2.2% of GDP	1.8% of GDP	1.9% of GDP
Increased VAT revenues;	MoF	7.5% of GDP	7.6% of GDP	7.7% of GDP
Increased revenues from excise duties.	MoF	4.35% of GDP	4.26% of GDP	4.2% of GDP

6.2 Priority 2: Improve Revenue Collection Through Increased Efficiency and Productivity of the Tax System

Table 6.2 Improve Revenue Collection Through Increased Efficiency and Productivity of the Tax System

Indicators	Data sources	Baseline (2018)	Mid-term (2021)	Target (2023)
Increased PIT efficiency	MoF	PIT efficiency 0.27	PIT efficiency 0.28	PIT efficiency 0.29
Increased CIT efficiency	MoF	CIT efficiency 0.18	CIT efficiency 0.19	CIT efficiency 0.2
Increased VAT efficiency	MoF	VAT efficiency 0.52	VAT efficiency 0.53	VAT efficiency 0.54
Lower tax arrears	PRO	4.46% of GDP	3.7% of GDP	3% of GDP
Established registry of beneficial owners	FIO	Not established	Established	Established
Increased number of conducted supervisions over the	FIO	39	44	50

implementation of the AML/CFT measures				
Reduced shadow economy	IMF	38%	34%	25%

6.3 Priority 3: Increase Tax Transparency

Table 6.3 Increase Tax Transparency

Indicators	Data sources	Baseline (2018)	Mid-term (2021)	Target (2023)
Introduced OECD common reporting standard	OECD	Not implemented	Not implemented	Implemented
Ratified EU convention for exchange of information (Naples 2)	Official Gazette of the Republic of North Macedonia	Not ratified	Ratified	Ratified
Introduced System for Exchange of Excise Data	CA	Not introduced	Not introduced	Introduced
Organized trainings for taxpayers	MoF, PRO, CA	26	33	40
Published informational materials and reports	MoF and PRO	Not published	Not published	Published

6.4 Priority 4: Improve Quality of Services

Table 6.4 Improve Quality of Services

Indicators	Data sources	Baseline (2018)	Mid-term (2021)	Target (2023)
Upgrade of system for pre-filled PIT returns for citizens	PRO	No such system	Functional system	Functional system
Increased percentage of digitalized services	PRO and CA	40%	60%	70%
Shortened time for paying taxes	World Bank, Doing Business	119 hours per year	100 hours per year	90 hours per year
Improved distance to frontier of Trading Across Borders indicator	World Bank, Doing Business	93.9	95	97
Increased number of tax auditors	PRO	15.7% of the employees	17.5% of the employees (20 new employments)	20% of the employees (45 new employments)

6.5 Priority 5: Introduce Green Taxation

Table 6.5 Introduce Green Taxation

Indicators	Data sources	Baseline (2018)	Mid-term (2021)	Target (2023)
Established framework for environmental taxation	MoF	-	Analyzing current legal arrangements on pollution taxation and drafting proposals for their improvement	Possibilites for taxation of certain products, towards taxation based on CO2 emissions
Lowering custom tariffs for environmentally-friendly products	CA	-	Lowering or eliminating custom tariffs for 25% of the eligible products	Lowering or eliminating custom tariffs for 50% of the eligible products
Communal fee related to pollution	MoF	No such fee	No such fee	Introduced fee
Increased revenues from duties on pollutants	MoF	-	5% growth revenues from duties on pollutants each year	5% growth revenues from duties on pollutants each year
Motor Vehicles Tax based on CO_2 emissions	MoF	0% of motor Vehicles Tax is based on CO2 emissions	25% increase of the value of the CO2 tax rate (until 31 December 2021)	50% increase of the value of the CO2 tax rate

7. RISK ASSESSMENT AND MANAGEMENT OF THE STRATEGY

The table below shows how risk in implementation of the Strategy is assessed and how it will be managed. Each individual risk noted previously is first classified into three possible levels - low, medium and high. Mitigation measure for each individual risk is proposed then. The institution which is responsible for taking the mitigating measure is identified in the end.

Risks will be followed by the TSRS WG. Risk assessment will be updated on annual basis, when there are significant changes in underlying risks or when there are actions for risk mitigation.

Table 7.1 **Risk implementation of the Strategy**

Risk Level	Systems and institutional structures in place	Impact on overall objectives in case of risk occurrence
LOW	Are strong enough to make occurrence unlikely	Limited
MODERATE	Should prevent occurrence, but additional monitoring is necessary	Early detection would limit impact to a delayed attainment or a partial achievement of the results
SUBSTANTIAL	Are not sufficiently robust to guard against the occurence of the risk	If the risk cannot be detected and prevented, it would significantly disrupt the achievement of the results in the priority concerned
HIGH	Are too weak to prevent the occurrence of risks	The occurence of the risk would result in a quasi failure of the priority or non achievement of key results

Table 7.2 **Risk assessment and management of the strategy**

Priority	Measure	Risk factor	Risk level	Mitigation measure	Responsible body
1. Increase fairness of taxation	1.1. Review the existing tax policy and introduce improvements	Insufficient political will for implementing the changes.	High	Raising awareness about the need and the benefits of implementing the measure.	MoF
		Lack of qualified experts for drafting the legal amendments.	Low	Engagement of experts in a timely manner.	MoF
		Insufficient support from stakeholders.	High	Active and continuous cooperation and communication with stakeholders that could provide support (experts, CSOs, IFIs etc.).	MoF
	1.2. Ensuring fair competition	Lack of expert technical assistance	Medium	Engagement of experts in a timely manner.	MoF, PRO
		Insufficient human resources capacities	High	Appropriate human resources management (hiring, training, motivation, retention).	MoF, PRO
		Insufficient political will	Low	Informing about the necessity of implementing the measure.	MoF
		Internal resistance to changes and insufficient commitment from the employees.	Medium	Implementation of change management	MoF, PRO
	1.3. Harmonization with EU and best practices	Lack of expert technical assistance.	Low	Engagement of experts in a timely manner.	MoF
		Insufficient human resources capacities.	Medium	Appropriate human resources management (hiring, training, motivation, retention).	MoF, PRO, CA, FIO, FP
		Insufficient political will.	Low	Informing about the necessity of implementing the measure.	MoF

Priority	Measure	Risk factor	Risk level	Mitigation measure	Responsible body
2. Improved efficiency and productivity of the tax system	2.1. Analysis of the tax base	Insufficient political will for implementing the changes.	Medium	Raising awareness about the need and the benefits of implementing the measure.	MoF
		Insufficient support from stakeholders.	High	Active and continuous cooperation and communication with stakeholders that could provide support (experts, CSOs, IFIs etc.).	MoF
	2.2. Reduction of tax arrears	Lack of will among officials.	Medium	Engaging in active communication with relevant officials.	MoF, PRO, CA
		Insufficient knowledge on the issue.	Medium	Establishing inter-institutional working groups for assessment of the issue.	MoF, PRO, CA
		Delays due to technical difficulties.	Medium	Timely provision of technical equipment and software.	PRO, CA
	2.3. Reduction of tax evasion	Insufficient human resources capacities.	Medium	Appropriate human resources management (hiring, training, motivation, retention).	PRO, CA
		Delays due to technical difficulties.	Medium	Timely provision of expertise, technical equipment and software.	PRO, CA
	2.4. Addressing illicit financial flows	Insufficient institutional capacities.	Medium	Developing a strategy for institutional capacity development	FIO
	2.5. Improving capacities of institutions of the tax system	Insufficient human and institutional capacities.	Medium	Strenghtening of units for human resources and IT	PRO, CA
		Delays due to technical difficulties.	High	Timely provision of technical equipment and software.	PRO, CA
		Lack of finances	Medium	Timely provision of financial support from donors	PRO, CA
		Internal resistance to changes and insufficient commitment from the employees.	Medium	Motivation of employees and commitment of high and medium management to implementation of the measure	PRO, CA

Priority	Measure	Risk factor	Risk level	Mitigation measure	Responsible body
3. Increase Tax Transparency	3.1. Improving exchange of information	Failure to receive expert technical assistance.	Low	Engagement of experts in a timely manner.	MoF, PRO, CA
		Insufficient administrative and human resources capacities.	Medium	Appropriate human resources management (hiring, training, motivation, retention).	MoF, PRO, CA
	3.2. Increasing availability and quality of tax-related information	Insufficient human and institutional capacities.	Low	Preparation of action plans in a timely manner.	MoF, PRO, CA
		Failure to prepare materials on time.	Low	Preparation of action plans in a timely manner.	MoF, PRO, CA
4. Improve quality of services	4.1. Improving services for citizens and companies	Insufficient human capacities.	Low	Strenghtening of units for human resources and IT	PRO, CA
		Lack of technical knowledge for project implementation.	Medium	Trainings for project implementation and engagements of external experts	PRO, CA
		Delays due to technical difficulties	High	Timely provision of expertise, technical equipment and software.	PRO, CA
	4.2. Improving control mechanisms	Insufficient human capacities.	Medium	Appropriate human resources management (hiring, training, motivation, retention).	MoF, PRO, CA, FIO, FP
		Lack of technical knowledge for project implementation.	Low	Trainings for proper implementation and preparation of twining projects	MoF, PRO, CA, FIO, FP
		Delays due to technical difficulties	Medium	Timely provision of expertise, technical equipment and software.	MoF, PRO, CA, FIO, FP
5. Introduce Green Taxation	5.1. Introduction of incentives for environmental responsibility	Insufficient knowledge on the issue.	Medium	Tranings on subjects related to the measure	MoF, CA
		Insufficient interest from stakeholders.	Medium	Raising awareness about the need and the benefits of implementing the measure.	MoF

Priority	Measure	Risk factor	Risk level	Mitigation measure	Responsible body
	5.2. Introduce framework for environmental taxation	Insufficient knowledge on the issue.	Medium	Trainings on subjects related to the measure	MoF, CA
		Delays due to technical difficulties.	Medium	Establishment of proper IT support	MoF, CA
		Insufficient support from stakeholders.	Medium	Raising awareness about the need and the benefits of implementing the measure.	MoF