

# TAX POLICY IN SMALL AND MEDIUM SUB-FUNCTION FUNDS

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## **Abstract**

Small and medium enterprises represent a very important base for a country's economic development. For their functioning, there is a need for free market, private property, freedoms and rights of individuals, as well as institutional support from state bodies. The largest expansion of the formation of small and medium-sized enterprises took place after the transformation of capital from state and social property into joint stock companies and private enterprises and the creation of legal conditions for their functioning. All countries that have passed the transition period try to create favorable conditions for business activities. This support is done through the deregulation of the old system, the adoption of laws for the development of the market of goods and services, the labor market and the free movement of capital market. With these reforms it is possible to create favorable conditions for business activities, limiting the state intervention to the economic life of the subjects as well as building the institutional infrastructure for the support of small and medium enterprises.

**Keywords:** Taxation System, Tax Facilitation, Tax Rate, Profit Tax, Personal Income Tax,

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## **1. INTRODUCTION**

Small and medium enterprises represent a very important and important base for a country's economic development. For their functioning, functioning of the free market, private property, freedoms and rights of individuals, as well as institutional support from state bodies, is needed. The largest expansion of the formation of small and medium-sized enterprises took place after the transformation of capital from state and social property into joint stock companies and private enterprises and the creation of legal conditions for their functioning. All countries that have passed the transition period try to create favorable conditions for business activity. This support is done through the deregulation of the old system, the issuance of laws for the development of the market of goods and services, the labor market and the free movement of capital market. With these reforms it is possible to create favorable conditions for business activities, limiting the state intervention to the economic life of the subjects as well as building the institutional infrastructure for the support of small and medium enterprises.

Key words: Small and Medium Entities, Taxation System, Tax Facilitation, Tax Rate, Profit Tax, Personal Income Tax, Value Added Tax, Excise Tax, etc.

One of the major pillars for economic development is small and medium-sized entities. Their share in gross income in each country is very large. They employ a considerable number of workers. Statisticians say that small and medium-sized entities are more innovating, in a time when innovations are the soul of the economy. It is noteworthy that even the development of the small economy contributes greatly to the development of the market structure, which means there is a subordinate dependence. The creation of a favorable climate requires broad involvement of the mechanisms available to the state, and there is a need for coordination of different activities. Small and medium enterprises are the main pillars for economic development in both developed and emerging economies. This is also evidenced by the participation of small and medium-sized entities in the structure of enterprises, the income they generate, their contribution to the reduction of unemployment, innovations, etc. Economic development cannot be imagined without development of small and medium enterprises.

Therefore, it is very important to analyze the tax policy, the effects of this policy on the development of small and medium businesses. However, for its development, it is not only important the efficient taxation policy but also the institutional support, where we will mention: creating a favorable business climate, organizing seminars and tables for outsourcing strategy in foreign markets, providing of payments by promoting the functioning of factoring for the sales of claims both in the domestic market and in foreign markets, cooperation between businesses and universities in order to find ways to overcome the problems and difficulties they face.

## **2. OBJECTIVE AND AIM OF THE RESEARCH**

The objective of the study of this paper is to analyze the impact of tax policies on the development of small and medium enterprises. Although the impact of direct taxes is very evident, however, I find it reasonable that the study also includes the impact of value added tax due to the fact that Macedonia continuously increases the tax threshold that by law obliges small and medium-sized firms to be included in the tax system on the added value.

These enterprises, first of all by seeing their capacities apart from the institutional facilities, apart from state bodies require at the same time an efficient lending system, where the state will guarantee their loans, and so on. Developed countries in the focus of their macroeconomic development strategies, using concrete measures, create a fiscal policy that includes tax relief that impacts on reducing business costs, revenue growth and profitability. Although Macedonia has made some reforms in its tax system, or it has lowered the tax rates, still the impact of external factors, in particular political-legal factors, create uncertainty among businesses, reflecting the low level of external and interior investments. Here in the beginning it should be mentioned the adoption of several laws, namely the Law on financial discipline which law significantly damages the small businesses every day. If we take a parameter, the rate of punishment imposed on businesses, but which is increasingly burdened by small businesses, the rate of punishment is greater than that of the region and even wider.

To adapt to the circumstances and socio-economic systems, the tax system is constantly amended and supplemented to meet the public needs for financial means, but those sums of accumulated funds do not pose a burden on businesses and citizens.

## **3. PRESSURE, UNDERSTANDING AND TYPES**

Taxes are money income of the state that is determined and enforced by law, and are not reimbursable, nor is there any compensation for them. Taxes and customs are the main sources of financial means to carry out the functions of state. Microeconomic business taxes

are causing costs due to the fact that products or services they provide to consumers become expensive depending on the rate or tax burden that is imposed on them. While a large number of taxes are paid to people, i.e. consumers, this again affects the price increase that directly reduces sales.

Economist Nobel Prize Laureate, US President Joseph Stiglic, has defined<sup>1</sup> the "Five Preferred Characteristics of Every Tax System", which can be identified as the most appropriate tax principles of the time:

- economic efficiency - the tax system should not undermine the efficient allocation of resources;
- the administrative-tax system's to be simple and economical in the application;
- The elasticity - the tax system to be adjusted (preferably automatically) to the country's economic conditions;
- political responsibility-tax system and tax burden to be result of political will of citizens; and
- the tax-system-equity to be fair in relation to citizens with different incomes, which is a modern challenge of all tax systems.

Taxes can be divided into several categories, but a more common division is direct taxation and indirect taxation.

Public revenue are financial assets that the state collects to cover public expenditures. The state with these assets covers state functions. Public revenues are formed during the distribution of the overall domestic product. Public revenues represent assets that the state provides through taxes, customs, taxes, contributions and other data specified by relevant laws.

However, taxes represent a very important category of public income. Therefore, the way the state regulates the tax collection, the rate of taxation, the payment period is very important for the functioning of the state and its organs on one side, and also the impact of these taxes on the development of businesses and the population on the other side. The tax is a type of public income, with which the state, from the legal and physical entities under its control, receives the financial means, without any compensation, to meet their needs.

The tax system means a wholeness that includes tax regulations and procedures, tax rates, linked to a single mechanism, in the pursuit of the implementation of tax policies defined in macroeconomic policies and the state budget and local government units.

Macedonia's tax system consists of several types of taxes. According to the internationally acceptable classification, the tax system consists of several types of taxes:<sup>2</sup>

*I. Income taxes, II. Consumer spending, III. Property tax IV. Contributions for pension and disability insurance and health insurance*

Taxes are divided into two main groups: direct taxation and indirect taxation. Direct taxes are those taxes that tax the income, regardless of whether they are income generated by the enterprises or from citizens. With direct taxation except the fact that taxes are taxed, wages, rents and dividends are also taxed. Cross-border taxes are calculated and paid for by the flow of goods, products and services.

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<sup>1</sup> Abdylmenaf Dr. Bexheti, Financat Publike, Tetovë,2007, faqe 96

<sup>2</sup> Abdylmenaf Dr. Bexheti,financat publike, Tetovë,2007, faqe 102

<sup>3</sup> Zhivko Atanasovski, Javni finansii, Shkup 2005, faqe 541

### 3.1. Tax reform reforms in Macedonia

Macedonia, after the separation from the Yugoslav Federation, made several reforms that positively impacted the social economic development.<sup>3</sup> Taxation is an important economic, financial and social process. Tax policies and the tax system have an impact on development policies both in macro and micro-economic aspect. Taxes regardless of their type have three common characteristics: the tax object that implies the subject of taxation, the taxpayer who implies the economic entity or the citizen who would have to pay the tax as well as the tax base (applying the respective rate also determines the tax burden).

The tax object relates to the type of income categories to be taxed, from which the taxpayers will collect the tax. Tax objects are profit tax, personal income tax, property tax, and other taxes. Significant tax reforms Macedonia made when it adopted the Law on Value Added Tax (VAT) that replaced the Law on the Movement of Goods and Services. Taxpayers are all residents and physical persons residing in R.M. as well as non-resident natural and legal persons carrying out economic activity in R.M. and generate income.

### 4. TAX ON PROFIT

Tax on Profit is part of the direct tax group. This type of tax is paid by all trading companies, regardless of their status, capital ownership and its size if they have made a profit. It is paid on the basis of the financial result, as a difference between total income and total wages, depending on fact if the firm has made a profit. Profit represents the difference between total income and total outcome, in the values determined on the basis of statutory accounting acts and accounting standards, with the exception of income and expenses for which another way of assessment is determined by law.

This profit is added to all the tax charges established by the Law that raise the profit tax base and subtract all tax reliefs that affect the reduction of the tax base. Profit tax rate is 10% proportional to all businesses regardless of the amount of profit they have made.

In the Republic of Macedonia in addition to the established tax rate for profit tax of 10%, there is a legal possibility that the income realized from all sources for the calendar year for which the profit tax is determined, that do not exceed the amount of 3.000.000 Denars, annually. These taxpayers are permitted to pay annual tax on general income.

Other categories are all commercial companies that according to the provisions of the Law on Profit Tax can determine that the calculation and payment of annual tax on general purpose income provided:<sup>4</sup>

1. Carry out economic activities, excluding banking, financial, insurance activities and activities in the field of gambling and entertaining games; and
2. The total income in the year for which the tax is determined by any source shall be in the amount of 3.000.001 to 6.000.000 denars annually.

The chosen tax model companies will not be able to change over the next three years if they generate a total annual income of 3.000.001 to 6.000.000 denars in the next three years.

The resident taxpayer in the Republic of Macedonia, the profit he has earned at work abroad, has paid the profit tax in the other state reduces the accrued tax in the country, for the

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<sup>4</sup> Article 38, paragraph 1 of the Law on Profit Tax.

<sup>5</sup> Law on Profit Tax (Official Gazette of RM, 80/93 ... 112 / 2014,129 / 2015,23 / 17)

<sup>6</sup> Article 38, paragraph 1 of the Law on Profit Tax.

amount of profit tax paid abroad. In order to realize this right, the taxpayer submits a document from the relevant tax authority for the tax paid or held abroad.

### **5. PERSONAL INCOME TAX**

Personal income taxes are paid by persons in the total amount of net income from all sources, except for income that is excluded from the Personal Tax Law.

The personal tax is paid for the income that was realized during the calendar year and at the end of the year, exactly by 15.03.2017 all physical persons submit the application to the Public Revenue Office for all income earned during 2016. Tax The personal income is paid at the moment when the income is realized, and all income realized within the calendar year on a special form is submitted to the competent body which afterwards makes a decision, where it can accept all the information submitted or has additional information and charge the tax debtor with additional taxes.

The income that is subject to taxation consists of incomes realized at home and abroad.<sup>5</sup>

Taxation is subject to all proceeds, which are made in money, securities, material goods or in some other form.

Taxable income taxpayer is any natural person resident in the Republic of Macedonia for income earned in the country and abroad.

Resident within the meaning of this Law is a natural person who has a permanent place of residence in the territory of the Republic of Macedonia. The resident has a place of residence if on the territory of the Republic lives uninterrupted or interrupted 183 or more days from any month of the annual period. A taxpayer is also a natural person, who is not a resident of the Republic of Macedonia, for his/her income in the territory of the Republic of Macedonia.

Personal tax is paid at a rate of 10%.

The tax exemption is determined by the Ministry of Finance before the start of each year and is valorized by the planned increase of salaries of employees in RM for the year determined by the Macroeconomic Policy of the Government of the Republic of Macedonia.

In order to avoid double taxation, the taxpayer reduces the tax on personal income tax paid in the other state, up to the amount that will be obtained by applying the tax rate mentioned higher.

Personal taxes are paid by individual traders, based on the income realized. These taxpayers to the Public Revenue Office report income and submit their annual tax balance, at latest by March 15 next year.

### **6. COMPARATIVE ANALYSIS OF INCOME TAX AND PERSONAL INCOME TAX**

To do a comparative analysis between the profit tax and the personal income tax we will be served with a concrete example. We will take a small, three-person enterprise, a textile boutique with annual turnover of 3,000,000 denars. This is from the fact that enterprises that earn up to 3,000,000 denars do not pay tax on profits, while from the turnover 3,000,000 in turnover 6,000,000 denars the enterprise chooses to pay 1% of the total income or choose according to the financial statements, precisely the financial result according to the income and expenditure balance. The other case is a natural person, an individual trader who has also earned 3.000.000 denars

To better understand the impact of profit tax on commercial companies and personal income tax we have taken as an example two firms: one trading company and one individual trader. The average profit rate realized (realized margin) in both cases is equal to 25%, or in the amount of 750.000 denars, the same expenses are 350.000, the realized profit 400.000 denars in both cases

### Case I - The trade association and the individual trader earn income up to 3.000.000 denars

Legal form on profit	Turnover	Average profit rate	Revenues	Expenses	Profit	Tax
1.FIRM	3.000.000	25%	750.000	350.000	400.000	0
2.IND TR	3.000.000	25%	750.000	350.000	400.000	40.000

Another case is a commercial firm and an individual trader who also earns 6,000,000 denars

### Case II - The trade association and the individual trader earn income up to 6.000.000 denars

Legal form on profit	Turnover	Average profit rate	Revenues	Expenses	Profit	Tax on
1. FIRM	6.000.000	25%	1.500.000	700.000	800.000	60.000
2. IND TR	6.000.000	25%	1.500.000	700.000	800.000	80.000

### Case III - The trade association and individual trader earn 12.000.000 denars

Legal form	Turnover	Average profit rate	Revenues	Expenses	Profit	Tax on profit
1.FIRM	12.000.000	25%	3.000.000	1.400.000	1.600.000	160.000
2.IND TR	12.000.000	25%	3.000.000	1.400.000	1.600.000	160.000

If we analyze all three cases, one can conclude in the first and second case that the enterprise pays less profit tax than the individual trader, whereas in the third case, the two firms that are the subject of the research pay the same tax.

#### 6.1. Comparative analysis of profit tax and personal income tax based on the reduction of the tax base for investments in permanent assets (reinvested earnings)

Even in this case we will get both firms from the previous example, one is registered as a company and the other company is registered as an individual trader.

In order to clarify the impact of the profit tax on the commercial company with exactly the article that foresees that if the firm in the previous year realized a profit in the amount of MKD 1,600,000 and from the accrued profit (retained earnings) transferred to the investment fund, and in 2016 invested in permanent assets for carrying out the activity in the amount of 1.500.000 denars, the basis for tax calculation is 100.000 denars and the company will pay tax on profit on this basis and will be obliged to pay tax In profit of 10,000 denars.<sup>6</sup>

The individual dealer pays personal income tax and calculates and pays it according to this law. This law stipulates that in the profit realized in 2016, in the concrete case we assume that the individual trader has realized a profit of MKD 1.600.000 and has invested in permanent assets that are in function of the activity, the tax release will be 30% of the fodder can be reduced by the name of the invested profit that in the present case would be 480.000 denars or more up to 50% from the previous year's profit.

<sup>7</sup> Law on Personal Income Tax (Official Gazette of the Republic of Macedonia No. 80 / 93,187 / 13,13 / 14,116 / 2015,1219 / 2015,199 / 2015)

**Case 1 - The trade association and individual trader earn 12.000.000 denars**

Legal form	Turnover	Average profit rate	Income	Expenses	Profit	Tax base reduction for investments	Tax on profit
1.FIRM	12.000.000	25%	3.000.000	1.400.000	1.600.000	1.600.000	0
2.IND. TR	12.000.000	25%	3.000.000	1.400.000	1.600.000	480.000	112.000

**Case 2 - The trade association and individual trader earn 12,000,000 denars**

Profit from the previous year is 1.600.000 denars, the investment is 3.000.000 denars.

Legal form	Turnover	Average profit rate	Income	Expenses	Profit	Tax base reduction for investments	Tax on profit
1.FIRM	12.000.000	25%	3.000.000	1.400.000	1.600.000	1.600.000	0
2.IND. TR	12.000.000	25%	3.000.000	1.400.000	1.600.000	800.000	80.000

The second limiting factor under the Law on Personal Income Tax is that the tax base for investments can be reduced to 50% of the profit from the previous year, which in this case is 800,000 denars (50% from the profit 1,600,000)

From the examples we have analyzed, we can freely say that in terms of income taxation that legal entities pay in the form of profit tax, or income earned by individual traders that are classified as natural persons, we can say that favored are the enterprises compared to individual traders.

**CONCLUSION**

1. The tax system in the Rep. of Macedonia is characterized by low tax rates, but there is uncertainty among domestic firms as well as with foreign investors over how long these tax rates will apply;
2. Tax Inspection Control by persons authorized by the tax administration has no preventive and credible character, but this is characterized by high fines which in most cases are factors of bankruptcy of businesses;
3. Expenditure of budget funds is followed by many uncertainties and the financial means paid by enterprises and natural persons do not go to development destinations;
4. Small businesses and new businesses do not have any tax relief;
5. For small business the legal form business organization with a person or partnership from income tax analysis is more favorable to the trading company than individual commercial juridical forms;
6. Representation fees should be accepted up to 50% as they are due to attracting customers, expanding business and are in the function of the enterprise's activity.
7. Income should be taxed when the enterprise has economic benefits, in accordance with IAS 18-T revenues, means in the collection realized (based on the cash method) and not as it is now in billing performance.

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