

Report from the CSOs' consultations meeting on the tax treatment of Civil Society Organizations

The tax framework for civil society organizations (CSOs) is an important element of the environment in which they operate. It can encourage their development and sustainability, but it can also create barriers for the functioning of civil society organizations. The favorable tax framework should reflect the specifics of the operation of CSOs, different from that of commercial entities, recognize the operation of CSOs in the wider public interest and provide tax incentives for donors to civil society organizations. As civil society sector is relatively young in North Macedonia, the tax system in rare instances recognizes CSOs as specific entities different from the companies and the public institutions and there is lack of knowledge within the authorities to understand the specifics of the CSOs. Thus, when designing effective and enabling proposals for the tax framework for CSOs, it is of outmost importance that the CSOs are actively included in the process. This will enable them to articulate their needs, identify deficiencies and gaps in the existing taxation regime and jointly draft proposals.

Having this in mind, around forty representatives of Civil Society Organizations and experts took part in the consultation meeting organized on the 28th of February 2023 in the framework of the EU funded Project "Technical Assistance for improving the enabling environment for Civil Society Organizations in the Republic of North Macedonia". The purpose of the meeting was to contribute to the improvement of taxes that are important for CSOs. The consultation meeting was timely as there are several ongoing processes for amendments in the existing legal framework relevant to CSOs. In addition, the favourable tax framework is part of the goals and tasks of the strategy of the Government of the Republic of North Macedonia for cooperation with and development of the civil society 2022-2024 thus the meeting contributed to its implementation as well. During the consultation meeting, the participants had an opportunity to: a) inform themselves about the existing tax framework (income taxation, value added tax and taxation of donations and sponsorships) in the European Union countries and in the Republic of North Macedonia; b) highlight the needs and challenges they face as CSOs in the application of the current tax framework; c) share their suggestions for changes and improvement of taxes to correspond to the needs and specifics of the civil society organizations.

The composition of the participants was diverse including large, well established organization, small grass-root organizations as well as the TA Project experts.

Content and discussion



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The discussion during the meeting evolved around three key tax issues: 1) income tax; 2) Value Added Tax (VAT) and 3) tax treatment of philanthropic giving. The agenda is included in Annex 1 of this report. The document Overview of best practice in tax treatment of CSOs in the European Union prepared under the Project served as a background for the discussion. In the introductory session, Ms. Irena Ivanova, Representative of the Delegation of the EU in the country provided the opening remarks into the topic confirming the commitment of the EU to support the institutions and the CSOs in creating enabling tax framework for the CSOs in line with the EU Guidelines for the Civil Society. The meeting continued with opening each of the three key tax aspects whereby the Project expert provided introduction into the issue, outlining the comparative practice of the EU and the existing legislation in North Macedonia. This was followed by an open, plenary discussion among the participants.

Overall, the participants welcomed the organization of the CSOs consultations meeting. They stated that there are not many opportunities where they can inform themselves about the key taxation issues and the ways they relate to their work. Thus, many of the participants used the meeting to learn about the proposals for possible improvements in the tax framework and reflect on their experience and work rather than shape any specific tax recommendations.

Income tax

In regards to the income tax, after the presentation on the comparative examples from the EU and North Macedonia, the participants discussed the following questions:

- What is the existing experience in the implementation of the legislation on income tax? Is the legislation clear?
- Does it encourage the CSOs to generate own income from economic activities (including non-mission related activities)?
- Is the existing tax treatment appropriate compared to the treatment of the commercial entities?

The participants agreed that it is important foremost that the Law on associations and foundations is liberal towards CSOs conducting economic activities to support their sustainability. This is of particular importance having in mind the low level of financial support from the Government, the requirements for cost-share on donor-funded projects as well as the growing interest for establishing social enterprises among the CSOs which rely mostly on economic activities. Reflecting on the EU comparative practice, it should be considered whether non-mission related economic activities could be allowed as well which can then be treated accordingly with properly with the profit income tax. It was also discussed that in the EU the legislators and tax authorities are not very concerned in regards to the mission-related economic activities of the CSOs as they are not considered to be in unfair competition with



the market and the taxation efforts are mostly focused on the non-mission related economic activities.

Based on the experience and impression of the participants, it seems that at this point the existing taxation of the income stipulated in the Law on income tax is suitable for majority of the organizations as they rarely generate more than 1.000.000 denars income from economic activities. However, with the growing trend of social enterprises in the near future this might be an issue for growing number of CSOs. In addition, if the CSO would like to generate income from economic activities to cover their cost-share on donor-funded projects, the threshold of 1.000.000 denars is too low and would create additional tax burden for the organization.

Moreover, it was discussed that while for the CSOs whose economic activities do not entail major costs related to those activities the taxation on the overall income might be suitable, this would not be the case for those organizations whose expenses related to the economic activities are high. For this reason, it was suggested that instead of opting for a fixed income tax treatment, more flexible approach could be introduced. Namely, the CSOs could have a possibility to opt for either taxation on the overall income (as it is at the moment), or the taxation based on surplus as it is for the mainstream companies. In this way the organization can have an option to decide which tax treatment is better suited for their economic activities as it is for the profit entities.

Value Added Tax (VAT)

The VAT was discussed in relation to the input VAT (when CSOs purchase goods and services) as well as the output VAT (when CSOs are providers of goods and services) reflecting on the following questions:

- What is the existing experience in the implementation of the VAT legislation?
- Are CSOs facing challenges in its implementation and how these challenges can be overcome?
- Can the VAT treatment of CSOs be improved by alleviating the financial burden of the input VAT in particular for the small CSOs etc.?

In comparative perspective, the input VAT is a challenge for many CSOs in the EU and they are rarely returning back the VAT unless they have economic activities that generate income above the VAT threshold. It was discussed that in North Macedonia, the input VAT is exempt on the donor-funded projects and on purchases made with donations from local entities (under the burdensome procedure of the Law on donations and sponsorships in the public activities). However, the VAT on the cost-share part of the EU-funded projects is not covered with the VAT exemption and it was concluded that this should be a viable improvement having in mind that the government's cost-share is included in the VAT exemption. In addition, many small CSOs do not implement donor-funded projects thus they have to pay VAT on all their expenses which increases their costs. Inspired by the examples of input VAT refund scheme



for charities as well as “Moj DDV”, the participants suggested that some form of input VAT return would be beneficial for small and grassroots CSOs.

As for the output VAT, EU and North Macedonia legislation ties it to the services rather than the type of entities. The analysis and the discussions have noted that improvements can be made in the VAT treatment on the food donations with simplifying the procedures. In some EU countries the services CSOs provide to their members if they don't interfere with the fair market competition are exempt from VAT which would be something to consider in North Macedonia as well.

Tax treatment of philanthropic giving

In the EU comparative perspective, the tax treatment of the philanthropic giving is the most complex and diverse as it depends on the overall taxation system, civil society and philanthropy traditions and development etc. Thus, the best practice in this area should be observed on the level of principles and trends in the tax treatment of philanthropic giving. While North Macedonia has broad spectrum of tax incentives, it was discussed that changes to the Law on donations and sponsorships in the public activities (LDSPA) are necessary in order to effectively encourage local donors and promote the culture of giving. After the presentation by the expert, the following questions were discussed:

- What is the existing experience from the implementation of the tax incentives on the philanthropic giving?
- Are the CSOs experiencing challenges in their implementation and how to mitigate those challenges?
- Can the tax incentive be improved? Is there a need for additional tax benefits on donations to CSOs with Public Benefit Status (PBO status), multi-year donations etc.?

The participants shared their experience as well as dilemmas in the implementation of the LDSPA. Some have faced difficulties in undergoing the administrative procedures for tax benefits under the LDSPA while others experienced challenges in determining the taxation issues related to charity fundraising activities. As the ex-ante administrative procedure for obtaining the tax benefits does not exist in any of the other European countries, it was also agreed by the participants that the procedure should be simplified following the best practice of the EU countries. Furthermore, it was discussed that it is more beneficial to find a viable and efficient solution for the PBO status rather than interfering with the VAT law and other systematic tax solutions.

During the consultations meeting the participants also addressed other issues and challenges they have in relation to their financial management and sustainability such as the



law on accounting for non-profit organizations, the implementation of the EU-funded projects, the necessity for the Government to recognize and remunerate the policy expertise provided by the CSOs etc. It was concluded that further consultations and events are needed to continue the discussions related to the issues pertaining the financial sustainability of the CSOs.

Concluding remarks

Based on the discussions, the main conclusions can be summarized as follows:

- There is an apparent lack of knowledge and user-friendly information about the tax framework for CSOs. In particular, smaller organizations face difficulties in navigating through the tax and financial system. Thus, it is important to organize similar events, sessions and support services to improve the capacities in the sector and assist the CSOs in properly understanding the pertaining taxes.
- There is a space for improving the tax framework for CSOs in all of the discussed types of taxes. Policy recommendations should be outlined and shared with the institutions. In parallel, they can be used as advocacy tool for the CSOs.
- As all taxation aspects cannot be addressed at once, a plan prioritizing the issues needs to be outlined. In this regard, it is important to coordinate and converge the existing processes of drafting and revising the legislation relevant to the CSOs. This in particular refers to the revisions in the Law on associations and foundations, the draft Law on social enterprises and the revisions in the Law on donations and sponsorships in the public activities. Other issues such as the return on the input VAT etc. could be addressed in the next stages of policy revisions.
- Further consultations and meetings with the CSOs in shaping the policy recommendations are needed. These meetings should occur with a smaller group of selected CSOs with experience and expertise in sector-related issues in particular taxation, financial work of CSOs and CSO legislation.



ANNEX I – Agenda for the CSOs consultations meeting

CSOs consultations meeting on the Tax treatment of Civil Society Organizations

February 28, 2023

Venue: Hotel Panoramika with possibility of online participation

Agenda

10:50 – 11:00 Check-in of participants

11:00 – 11:05 Opening and introduction to the meeting

– *Nikica Kusinikova, expert*

11:05 – 11:10

Welcoming remarks and info on the project

- *Irena Ivanova, EUD*

11:10 – 11:40

Taxation of income

- Presentation of the comparative overview in the EU and in North Macedonia – *Nikica Kusinikova, expert*
- Q&A, discussion on the taxation of income (plenary discussion)

11:40 – 12:10

Value Added Tax

- Presentation of the comparative overview in the EU and in North Macedonia – *Nikica Kusinikova, expert*
- Q&A, discussion on the VAT (plenary discussion)

12:10 – 12:40

Tax treatment of philanthropic giving

- Presentation of the comparative overview in the EU and in North Macedonia – *Nikica Kusinikova, expert*
- Q&A, discussion on the taxes on giving (plenary discussion)

12:40 – 12:45 Conclusions and next steps



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