



Policy study 16

Individuals in the VAT system and the rule of  
law in Macedonia

With a special reference and recommendations concerning  
authorship contracts

**Marjan Petreski**  
**Marjan Nikolov**  
**Vesna Garvanlieva**  
**Borche Smilevski**

Policy study 16

# Individuals in the VAT system and the rule of law in Macedonia

With a special reference and recommendations  
concerning authorship contracts

Marjan Petreski<sup>1</sup>  
Marjan Nikolov<sup>2</sup>  
Vesna Garvanlieva<sup>2</sup>  
Borche Smilevski<sup>3</sup>

---

<sup>1</sup>University American College Skopje / Finance Think – Economic Research & Policy Institute, Skopje.

<sup>2</sup>Center for Economic Analyses, Skopje

<sup>3</sup>Center for Tax Policy, Skopje



This product is prepared within the project “FISCAST+: Fiscal transparency and accountability improves policies in quality of life, education and health” funded by the UK Government with the support of the British Embassy Skopje. The content of this publication does not necessarily reflect the position or the opinions of the UK Government.

## Content

<b>1. INTRODUCTION.....</b>	<b>3</b>
<b>2. TAXES AND THE RULE OF LAW .....</b>	<b>5</b>
<b>3. PRINCIPLES ON VAT TAXATION OF INDIVIDUALS .....</b>	<b>8</b>
<b>4. AUTHORSHIP CONTRACTS IN THE VAT SYSTEM? .....</b>	<b>13</b>
4.1. SUPPLY IN AUTHORSHIP CONTRACTS.....	14
4.2. PRODUCING A GENERAL PUBLIC GOOD.....	17
4.3. CONTRACTS FALLING WITHIN THE VAT SYSTEM.....	20
4.4. PURCHASERS OF AUTHORSHIP CONTRACTS FALLING OUTSIDE THE VAT SYSTEM.....	20
<b>5. CONCLUSIONS AND RECOMMENDATIONS .....</b>	<b>24</b>
<b>6. REFERENCES.....</b>	<b>26</b>

## 1. Introduction

The deterioration of the rule of law, low accountability and transparency, particularly concerning the spending of public money, the perception of senior government officials' impunity and ignoring the voice of civil society in general contributed to the turning point of the parliamentary elections in December 2016. With the help of civic engagement and extraordinary efforts by the international community, the opposition headed by the Social Democratic Union of Macedonia got a fair chance to form a government. Under the maxim for bringing back the rule of law and restoring civil liberties, several societal stakeholders, in the country and abroad, enabled the establishment of a new democratic government in June 2017.

The formation of the government in June 2017 decreased the political pressure on the social and economic environment, which seemed vital for the development of economic processes, which were and still are necessary to increase the standard of living of the population. For the expert and general public, it was enough that the Government declared its commitment to an inclusive debate respecting everyone's right to the freedom of speech and to an inclusive consultation process accepting different expert opinions; thus, their actions will be to the benefit of the public good, which applies also to the development, adoption and enforcement of laws.

The debate on the rule of law is not a new debate in Macedonia. The rule of law, or lack thereof, was the main line of concern in the period of the previous government, *inter alia*, noted or put forward as an argument also in the debate by the then opposition. However, when the current government was in the position to show a different approach regarding the broad spectrum of the rule of law, initial concerns appeared in the expert public and civil society about the rule of law in the tax area.

Hence, the purpose of this policy study is to analyse the issue of value added tax (VAT) for natural persons in the context of the rule of law. The study gives a special review of authorship contracts in the VAT system, which in their essence are the same as the contracts concluded by legal entities, but which do not involve any supply.

The VAT Law was adopted in 2000, when the VAT replaced the then turnover tax. VAT is a multi-stage tax concerning the added value, where the taxation is done at the moment of supply or import of goods and services in the country. Even then, the law regulated that a taxpayer shall also be a natural person carrying out an independent business activity, but it primarily aimed to cover sole traders carrying out a commercial (business) activity, such as craftsmen, hairdressers, transporters, farmers, petty merchants etc. Thus defined, the Law requires independent persons carrying out an activity to be registered as VAT payers when their income in the calendar year exceeds a given threshold, the amount of which changed throughout the years and is currently MKD 1,000,000. According to this definition, the VAT regime already includes all sole traders carrying out a business activity, or supplying goods or services the turnover of which exceeds the threshold envisaged. In 2014-15, the government defined in more detail the activities subject to VAT and included in this regime also the members of management and supervisory boards, and the persons renting business premises to firms. The first amendment was aimed at discouraging companies from discounting the salary for top managers and paying high amounts for memberships in boards, thus avoiding to pay social contributions. The second amendment was aimed at discouraging the rental of personal property to their own firms, as a way of extracting funds from the firm with an effective rental tax rate of 7.5%. This was, approximately, the period when the public debate imposed the thesis that all individuals earning income over the specified threshold are subject to VAT, irrespective of the income basis, except for the salary. The then government never addressed these rumours in the public, nor did it order enforcement of the law according to that rough interpretation.

The stance of the current government that natural persons – in the most general sense of the word, and not only sole traders – should be included in the VAT regime, heated the economic debate and caused public outrage in January 2018. By the end of the debate in that period of the year, it became clear that the Government was alone in its stance, while the unanimous opinion of the experts, academic public, civil society and tax agencies was that the general treatment of natural persons in the VAT system was without a clear, precise and unequivocal legal basis, and the potential actions by the tax authorities would leave room for selectiveness and bias, which all together leads to undermining of the foundations of the rule of law. The debate in that period of the year was closed with a statement by the tax authorities that it will be left to a voluntary registration of

natural persons for the purpose of VAT, at least until the legal provisions are defined in more detail and until the fulfilment of the election promise to raise the threshold for registration, which was interpreted by the stakeholders as a clear demonstration of the Government's will to respect the rule of law in the domain of the implementation of the VAT Law.

However, the concern among the stakeholders remained even after the public debate from the beginning of 2018 was closed. This study is intended to provide a basis for constructive debate in the public and with the tax authorities, concerning the issue of the treatment of natural persons in the VAT system, but also a comparative basis with the regulations and practices of other tax administrations, which as such should be included in the Macedonian VAT Law, so that the Law and its application demonstrate inclusion and rule of law.

The study is organised in the following manner. First, we give a broader overview of the rule of law in respect of the taxes and tax policies. Then, we address the principles in VAT taxation of natural persons. Then, we illustrate the risks of arbitrary inclusion of authorship contracts in the VAT system. Finally, we give specific recommendations for further legislative regulation of this matter.

## 2. Taxes and the rule of law

Rule of law as a concept is not only important in and of itself to ensure a just society, but also to enable the environment to achieve economic growth and development. Good governance inherently includes much more than just power of the state or strength of the political will. The rule of law, transparency and accountability are not only technical issues for the administrative procedure or institutional design, but rather they are an outcome of the level of democracy in the processes. The public finance system should be based on transparent procedures and rules, because well-established procedures and rules applied and observed without exceptions reduce the possibility for discretionary policy-making, resulting in predictability and reliability in the environment for attaining the objectives of the economic agents.

The rule of law, or the lack thereof, was the main line of concern among the domestic and international community, culminating with the clearly noted

designation of Macedonia as a captured state (European Commission, 2015). Theoretically, fully informed voters will provide an environment for politicians to make policies that are optimal for the society and based on the principles of the rule of law. However, the failures resulting from a greater or lesser extent of discretionary policy-making are common.

In Macedonia, two recent examples from the economic sphere became known to the general public. First, the legal regulations were not complied with in respect of the VAT refund, amount, which after a long period of criticism from the business sector, was finally publicly disclosed in September 2012 when the President of the Government revealed before the business community<sup>4</sup> the delay by the state in meeting the deadlines for settling the VAT debts, together with a plan and commitment to settle them by February 2013. Another example is when, in the end of 2015, the private funds of the second pension pillar revealed that the state pension fund of the first pillar is late in making the payment of funds collected on their behalf from pension insurance contributors<sup>5</sup>.

In reviewing the rule of law in the context of the tax system, we have to provide answers to the following questions: Are the rules sufficiently clear and comprehensible? Are the rules predictable? Are the rules equally applied in a neutral manner, without favoritism and economic deviations? Are the rules easily bypassed?

The generally accepted rules as indicators of a good tax policy are: equity and fairness, certainty, effective tax administration, information security, tax neutrality, economic growth and efficiency, transparency and visibility, minimum tax gap and accountability to taxpayers. Introducing important changes in the tax laws modifying the basic principles of taxation – with a different and, potentially, retrogressive application of the law without its amendment, is in clear breach of these rules.

The 'Guiding Principles of Good Tax Policy', published by the American Institute of Certified Public Accountants in 2017<sup>6</sup>, explaining the standard principles of taxation, states that "*certainty is important to a tax system because it helps to improve*

---

<sup>4</sup> <http://faktor.mk/dali-vrak-an-eto-na-dolgovite-na-drzhava/vo-koi-zemji-kolku-se-shtedi>

<sup>5</sup> <http://faktor.mk/drzhavata-dolzhi-fantastichni-13-milioni-evra-na-privatnite-penziski-fondovi>

<sup>6</sup> American Institute of Certified Public Accountants, 'Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals', (AICPA, 2017), <https://www.aicpa.org/ADVOCACY/TAX/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf>



*compliance with the rules and to increase respect for the system. Certainty generally comes from clear statutes as well as timely and understandable administrative guidance that is readily available to taxpayers”.*

As regards economic growth and efficiency, which nowadays are important to all economies, the same principles indicate that: *“The tax system should not unduly impede or reduce the productive capacity of the economy. The tax system should not hinder a jurisdiction’s economic goals, such as economic growth, capital formation, and international competitiveness. The principle of economic growth and efficiency is maximized by a tax system that is aligned with the economic principles and goals of the jurisdiction imposing the tax”<sup>7</sup>.*

During 2018, the (lack of) rule of law was again under threat with the arbitrary interpretation of the VAT Law<sup>8</sup>, specifically concerning the taxpayers – natural persons. The law has not been subject to any changes, amendments and/or supplements since 2016<sup>9</sup>, but the “new” interpretation and application of certain Articles from the beginning and in the course of 2018 by the legislators and those in charge of implementation of the law, in the absence of a clear answer on the compliance with the VAT principles, reflects unpredictability, inconsistency of the regulation, different and selective interpretation of the laws (or parts thereof). When read the provisions of the VAT Law should be clear, and not be subject to interpretation, otherwise that indicates a low level of governance and application of the law, but also a breach of the principles of good tax policy.

The issue on taxing individuals with VAT, i.e. the interpretation of the provisions of the VAT Law by state authorities, was again made a hot topic with the new government and the statements by the Ministry of Finance<sup>10</sup> that, in the general sense of the word, natural persons should be covered by the VAT system, which once again sparked off the debate and discussion reflecting the ambiguous regulation, an attempt for its precipitated application and biased interpretation, which demonstrated the need to clearly define aspects of the regulation and to prepare guidelines and rulebooks providing an answer and clarity to the

---

<sup>7</sup> American Institute of Certified Public Accountants, ‘Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals’, (AICPA, March 2001).

<sup>8</sup> Law on Value Added Tax (“Official Gazette of the Republic of Macedonia” No. 44/1999; 59/1999; 86/1999; 11/2000; 8/2001; 21/2003; 19/2004; 33/2006; 45/2006; 101/2006; 114/2007; 103/2008; 114/2009; 133/2009; 95/2010; 102/2010; 24/2011; 135/2011; 155/2012; 12/2014; 112/2014; 130/2014; 15/2015; 129/2015; 225/2015; 23/2016 and 189/2016).

<sup>9</sup> Official Gazette of the Republic of Macedonia 186/2016 dated 14.10.2016

<sup>10</sup> [goo.gl/6aSnW1](http://goo.gl/6aSnW1)



dilemmas arising concerning: (1) a clear definition of the business activity and supply, (2) continuous economic activity, (3) independence, (4) right of deduction etc.; hence, the need for a lack of application of the basic principles for a given tax regulation, namely: fairness, certainty, simplicity, clarity, neutrality.

### 3. Principles on VAT taxation of individuals

The Value Added Tax (VAT) is an indirect consumption tax, or tax on supply and import of goods and services, taxing the value added in each stage of production of a given product or service. According to the VAT Law (Article 9), a VAT taxpayer shall be a person permanently or temporarily carrying out an independent business activity, irrespective of the purposes and results from such business activity.<sup>11</sup> Business activity is any activity of producers, traders or persons supplying services for the purpose of obtaining income, including mining, agricultural and forestry activities, but also assignment of tangible and intangible assets to be used.

**In this section, we review three aspects of VAT taxation for natural persons, arising from the definition given above: business activity, independence and continuity.**

The definition of a **business activity** is broad, both in the European and Macedonian legislation. Its broad coverage, however, leaves room for an ambiguous, non-transparent and arbitrary application. This could be demonstrated by the fact that this definition is in contravention of some provisions in the Law on Personal Income Tax (PIT, Official Gazette of RM No.80/93 and its amendments). For instance, paragraph 2, Article 28 of the PIT Law states that “Income from business activity is income earned from a production, service, commercial, catering, transport and other similar activity”. According to this definition, in many cases, it will be clear that one activity is a “business activity” and it will fall under the scope of VAT. For instance, a greengrocer earning to cover the cost of living from the sale of vegetables is a clear “business activity”. However, paragraph 3 of the same Article in the PIT Law treats the income from professional

---

<sup>11</sup> The definition of a taxpayer is fairly uniform in the legislations of the European countries. See the Appendix at the end of this study.

and other intellectual services separately, meaning it does not subsume them under the business activity in paragraph 2 of the same Law, but treats them as independent activities only. Therefore, concerning the treatment of natural persons, **the first evident conflict in the regulation is between the VAT Law and the PIT Law**: the former tends to treat the business activity in a broader sense, without providing a clear and precise definition of that term, while the latter clearly separates the business activity from the professional services.

There is no other regulation defining the business activity in a clear and unequivocal manner. For instance, the Company Law (CL, Official Gazette of RM No.28/04 dated 30.04.2004 and its amendments) defines a **commercial activity**, in Article 4, in a similar manner as the PIT Law – as activities of purchase and sale of movables, trading in securities, transport, financial activities and insurance activities, hotel and restaurant services, printing activities, marketing services, etc. In this Law, the commercial activity is linked to earning profit. In this context, the classification of commercial activities under this Law clearly arises from the National Classification of Activities, which on the other hand means that the adjectives *commercial, business and economic* activity are synonyms for one and the same economic concept. **What is characteristic is that, in accordance with the Company Law (Article 8), the activity of natural persons carrying out an agricultural and forestry activity or craftsmanship is not considered as a commercial activity, unless their activity is defined as an enterprise, but also the activities of natural persons renting rooms in their own residence and natural persons engaged in liberal professions.** Therefore, in the context of providing a definition, the Company Law equates the commercial activity defined in this Law with the business activity defined in the Law on Personal Income Tax. **The second conflict concerning the definition of a business activity is between the VAT Law and the Company Law**, i.e. the former tends to treat the business activity in a broader sense, while the latter defines a commercial activity that clearly excludes professional services (liberal professions).

**The insufficient, ambiguous and inconsistent definition of a business activity in the Macedonian legislation allows arbitrary interpretation for tax purposes, creates legal uncertainty, thereby evidently undermining the rule of law.**

Let us give one simple example of a liberal profession of a scientist, an artist and an architect. According to the PIT Law, their profession is an independent activity (paragraph 3 under Article 28), i.e. it is not a business activity. According to the Company Law, their profession is not a commercial activity (paragraph 2 under Article 8).

The second aspect is **continuity in pursuing the activities**. It is much more difficult to understand whether the natural persons having sporadic activities and a limited amount of income are, in fact, a “business activity” or not. Hence, their income should be analysed **separately**, because some of them could be a business activity, and some not. For instance, let us take an individual registered as a self-employed plumber, who now starts to engage in overhaul and resale of old cars. This individual, for that particular activity, will not fall under the VAT system when selling the cars, because it is difficult to include his activity as a car overhauler in his business activity as plumber. However, if the plumber starts to give lessons in a local vocational school and earns income, then that income will be covered by the VAT system (unless the educational services are excluded by a special provision, as in the Macedonian VAT Law).

In the absence of precise legal provisions about what a “business activity” is, we will refer to the so-called **case law**. As an illustration, we will use the case from the British case law for the Morrison's Academy (CCE v Morrison's Academy Boarding House Association [1978] STC 1) concerning a charity, but which is indicative in the context of natural persons. Morrison wanted to build and maintain accommodation facilities for children attending their academy. The charity's memorandum indicated that the entire income must be used for the purposes of promotion of those facilities and that it cannot be distributed as profit or dividend. Parents whose children were accommodated in those facilities would pay a specific fee. Indisputably, this was considered as taxable supply. But, the key question was whether the supply is within the charity's business activity. **The court decided that it was not.**

Therefore, to determine whether a given activity of the individuals is a business activity, and also whether that is a taxable business activity, we could benefit from the answer to several challenges, which are encountered in the guidelines of tax administrations throughout the European Union. We provide an overview below.

1. **Is the activity performed for the purposes of making a profit?** This question should not be equated to the profit motive, because the profit

motive is not overriding. Even the VAT Law, Article 9, paragraph 1, prescribes that subsuming the activity in the category of taxable activities is “irrespective of the purpose and results”. But, if some activity is carried out for recreational purposes, then it shall not be considered as a business activity. The Lord Fisher case is useful to distinguish this aspect.<sup>12</sup>

2. **Is the activity an occupation or function, which is actively pursued with reasonable or recognizable continuity?** For a business activity to be VAT taxable, it has to be pursued with reasonable or recognizable continuity. The Morrison case is again useful here, specifically the statement by Lord Cameron that: “the supply must not be a sporadic or isolated transaction, but continued over an appreciable tract of time and with such frequency as to amount to a recognizable and identifiable activity of the particular person who is a taxpayer”.

Hence, for the business activity of the individual to become taxable, it has to be continuous. Currently in Macedonia, there is no definition of the continuity of a business activity, i.e. how often does the person have transactions through his/her business activity. This leaves room for arbitrariness and legal uncertainty in the interpretation of whether the transactions of a particular individual concern a continuing business activity.

3. **Is the activity predominately concerned with taxable supplies?** The Apple and Pear Development Council Case 102/86 of the Court of Justice of the European Union is an illustrative example in this context. It indicates that if an activity produces goods and services without making a turnover, or when those goods and services are produced for the general public good, then that activity does not involve taxable supply. An activity that does not involve taxable supplies cannot be considered as a business activity. This is also recognized by the Guidelines for Application of the Macedonian VAT Law, suggesting that:

---

<sup>12</sup> Lord Fisher used to organise free of charge shooting parties. However, when he faced growing expenses, he started collecting contributions from the participants to cover the costs. The question was whether that was done in the course or furtherance of the business activity. The Court rejected the claim by the tax administration that the specific activity was subject to VAT: The Court decided that, given the shoots were previously for free, it cannot be said that Lord Fisher was predominantly concerned with the making of taxable income for a consideration.

*“The supply of goods and services shall be taxable with value added tax according to Article 2 point 1 of the VATL, only if the supply is carried out for a consideration or if there is an exchange of performance. The exchange of performance suggests that there is a provider and recipient of the good or user of the service and that there is a counter performance for the supply (a consideration). For the assumption of an exchange of performance, the supply and counter performance have to be in an interrelation.”*

This is a very important aspect for authorship contracts of natural persons, and we have dedicated the entire section 4 to them.

4. **Is the activity carried out independently?** The independence in carrying out a business activity happens when the individual does not rely on instructions from an employer. This means that the activities within an employment contract cannot be considered as independent. Similarly, activities pursued outside of an employment contract, but with the same employer, cannot be considered as an independent activity. The decisions for appointment in management, supervisory and other bodies, in which the appointees refer to the instructions given by the authority that appointed them (Assembly of Shareholders, the state, etc.), also do not imply independence in the performance of activities.

Therefore, it is crucial to first define the business activity and to harmonize it between the different laws, so as to avoid its arbitrary interpretation. Then, it will be useful if each individual would register his/her business activity, from which he/she continuously obtains income, in a special register of activities. The activities for individuals could be extracted from the International Standard Classification of Occupations – ISCO-08<sup>13</sup> (unlike the activities of legal entities that are being registered according to the National Classification of Activities, as regulated in details in the Company Law). In parallel, the turnover generated by the individual from carrying out the registered business activity would fall within the VAT system. However, the legislator has to prescribe rules on when a given activity will be considered continuous. In this context, for the purposes of legal certainty and rule of law, we should not forget that such additional legislative regulation will introduce transactional costs for the individuals linked to the

---

<sup>13</sup> See more:

[https://ec.europa.eu/esco/portal/escopedia/International\\_Standard\\_Classification\\_of\\_Occupations\\_%2528ISCO%2529](https://ec.europa.eu/esco/portal/escopedia/International_Standard_Classification_of_Occupations_%2528ISCO%2529)

registration of a business activity and the individuals will also be forced to seek paid services from accountants.

#### 4. Authorship contracts in the VAT system?

This section concerns the **VAT treatment of authorship contracts**. Authorship contracts regulate the obtaining of income from a copyright and/or an industrial property right. According to the Law on Authorship and Related Rights (Official Gazette of the Republic of Macedonia No.115 dated 31.08.2010 and its amendments), a copyright is the right of authors of their works and the right of performers, phonogram producers, film producers, broadcasting organizations, publishers and database makers of their subject matters of related rights.

Therefore, authorship contracts could be and usually are concluded for (see also Law on Personal Income Tax, Official Gazette of RM No.80/93 and its amendments):

- Scientific-research works;
- Works of sculptors and painters;
- Musical compositions and cinematographic works;
- Restoration and conservation works;
- Translations;
- Other authorship works and industrial property works.

To treat the issue of **authorship contracts in the VAT system**, it is crucial that we elaborate minimum two aspects:

- (1) Whether the creation of the authorship work involves **supply of a service**, or transfer of copyright from the author to the purchaser; and
- (2) Whether the end consumer could be **personalized**.

These two aspects are analyzed below.

## 4.1. Supply in authorship contracts

The VAT Law, in Article 2, specifies that the following shall be **subject** to value added tax:

1. **Supply of goods and services** in the country for a consideration carried out by the taxpayer within the scope of his business activity; and

2. **Importation of goods.**

Then, Article 6, paragraph 2, point 3 indicates that the **transfer and assignment of copyrights**, patents, licenses, trademarks and other related rights shall be considered as taxable supply of services.

Therefore, the first criterion to assess the authorship contracts of natural persons – in respect of their coverage in the VAT system – is **whether they involve a supply**. In addition, it is particularly important to distinguish the **production** of an authorship work from the **transfer** of copyrights. For comparison purposes, let us take the production of a product, which is kept in stock in the company's warehouse. The particular product (or its value added) is not subject to VAT until it goes into supply, or until it is sold. The sale of the copyrights means their transfer from the author to the purchaser.

**The authorship contract is the creation, but not necessarily the transfer of copyrights.**

In the argumentation that each authorship contract does not involve supply/transfer of copyrights, we use several cases from the Court of Justice of the European Union (CJEU). In this context, the authorship contract will fall under the VAT system **only if it involves the supply of copyrights**. According to the Court of Justice of the European Union, the **supply of services** is the existence of:

- (1) **Consumption of a service**, or the supply of services for consumption by an **identifiable consumer**, or the service must provide a benefit regarded as a cost component of the activity of another person (legal entity or natural person) in the commercial chain. This is mentioned in both Mohr Case 215/94 and Landboden-Agrardienste GmbH Case 384/95, which concern research services (for instance, development of a study or research report), and suggest that in the cases when the research work is produced for the public good, or when its consumer cannot be personalized (we are



addressing this aspect separately and in more details in section 4.2), then **there is no supply of services.**

- (2) **Legal relationship** between the provider (author) of the authorship work and the purchaser (recipient) of the authorship work, pursuant to which there is a reciprocal relationship, according to which the remuneration received from the purchaser is the value constituting the actual (market) value given in return for the (performance of) the service offered by the provider. This is mentioned in the Tolsma Case 16/93.
- (3) **Direct link** between the authorship work offered and the service received. Any benefits from the supply of the authorship work must be conferred directly onto the person ordering the authorship work. It is not a supply if the person (legal entity or natural person) purchasing the authorship work only **indirectly** receives the benefit, for instance, if the benefit accrues to a wider group, an industry or the society as a whole. This is suggested in the Apple and Pear Development Council Case 102/86, and in “Keeping Newcastle Warm” Case C353/00. Similarly, the Tolsma Case 16/93 also indicates that the link between the goods and services subject to the contract (authorship works, in this case) and the fee paid must be such that a relationship can be established with the level of the benefits which the purchaser obtained from the service bought.

These CJEU cases suggest that:

- Authorship contracts in which there is a production of a copyrights **which remain with the author** do not involve a supply and fall outside the scope of VAT. Purchasers of such contracts are usually universities, scientific institutions, civil organizations, state and municipal authorities, international organizations; for more details see section 4.4. On the other hand, when a purchaser of the authorship work is a company, which implies that the consumer of the authorship work is identifiable, then the authorship contract falls within the VAT system. Even in that case, the most correct thing would be if those contracts are consultancy contracts (contracts for consultancy services) instead of authorship contracts.
- In authorship contracts **there is no valuation of the works** per days or other cost per unit of the author’s intellectual labor, thus they are outside the scope of VAT. Contrary to this, the direct purchase of a service from the author according to the value of his/her labor (remuneration per hour or

day) will fall within the VAT system. That is the case of consultancy contracts in which this **value** is expressed as cost of goods sold for one working day of consultancy services provided.

- In authorship contracts, the **production of a copyright is usually for the public good**, and not for the benefit of the purchaser, or the purchaser is not the direct user of the work produced. Accordingly, authorship contracts do not fall under the VAT system. On the other hand, a contract whereby the purchaser has an exclusive right to use the authorship work (including to sell it) is a contract that will fall under the VAT system.

Therefore, authorship contracts with a natural person are equal to contracts concluded by legal entities (usually universities, scientific centers and civil organizations) with other legal entities (donor organizations, universities, civil organizations) for the delivery of a public good. **These contracts could have a different name, but in their essence, they are the same.**

**Hence, a potentially different treatment of identical contracts of legal entities and natural persons is a clear indication of a failure to comply with the rule of law.**

Despite the general rules/principles listed above, each individual authorship contract should be reviewed according to its content and it should be assessed whether it meets the criteria specified above – **there is no consumption/supply of a service, there is no performance of a service expressed per unit of intellectual labor, and there is no legal entity or natural person directly obtaining a benefit from the service** - for the contract to be excluded from the scope of VAT. In continuation, we will list examples of authorship contracts that fall outside the scope of VAT, with their specificities:

- **Authorship contract for producing a research study/report intended for the 'general public good' and without direct benefit for the purchaser.** This type of contracts includes all contracts in which international organizations, domestic state bodies, universities, institutes and civil organizations conclude an authorship contract for development of a study on a given topic, from which they do not have a commercial benefit. The study is free of charge and publicly available to the wider audience, and the purchaser has only indirect benefit by contributing to the general public good (the purchaser encouraged the development or changed the course of a particular public policy, initiated a debate on a specific important issue,

increased the society's awareness about a certain issue etc.). The authors retain the authorships and could publish the study in an international journal or in a book.

- **Authorship contract in which no copyright or other intellectual property is produced**, or if such property is produced, then the findings can be freely used by any interested party and by the public. For instance, a contract whereby an artist obtains a honorarium to participate in a stage play that is freely available to the audience (no sale of tickets); or a contract whereby a singer performs musical compositions at an event that is open and free to attend; or a contract whereby a sculptor obtains a remuneration for a sculpture displayed in a park or square (public space). In the first two cases, there is no production of authorship ownership, whereas in the third one - the ownership produced is freely enjoyed by the entire public.

#### 4.2. Producing a general public good

The absence of a supply of services in authorship contracts is closely linked to the impossibility to personalize the end consumer. Although the personalization of the end consumer in the context of VAT for individuals was covered in section 4.1, in this section, we go back and elaborate this aspect in more detail. Pursuant to the decisions by the Court of Justice of the European Union, all tax administrations in the European Union adopted the following rule in their practice, according to which:

**When a “general public good” is subject to delivery in a (authorship) contract, then that particular contract is not VAT taxable.**

Let us take a closer look at the practice of the Irish and British tax administrations. To decide whether a (authorship) contract produces a general public good, we need to analyze several criteria, which are elaborated below.

1. **Nature of the contract.** If the findings/product of the authorship work (for instance, a study, report, sculpture, musical composition) are deliverables provided to the purchaser and only the purchaser has the right to their future use and publication, then this is a **consultancy contract** falling under the VAT system. In addition, given that these products are often being delivered electronically (e.g. a study or a musical composition), it is

important to distinguish the physical from substantive delivery. According to the British tax administration, in modern digitalization circumstances, the substantial delivery is crucial. To avoid any misunderstandings, the moment of delivery is linked to the **availability** of the authorship works after their production. Therefore, as a rule of thumb, whenever they are **freely** available to any interested party and to the general public, which implies that the purchaser **has no commercial benefit from the authorship works**, the fee paid for them is outside the scope of VAT.

2. **Authorship and industrial property rights.** If the purchaser acquires the copyright (transfer of the authorship rights), then that particular contract falls within the VAT system. Key element to distinguish the authorship consumption by the purchaser vis-à-vis by the general public is again the **availability** of the authorship work produced, as elaborated in point 1.
3. **Publications – reporting.** The availability of the authorship produced for the wide audience free of charge (on a non-commercial basis) and the remaining of the copyrights with the author implies that the **purchaser has no “power” over the publication(s) arising from the contract.** Such publication must be freely available to the wide audience. In many cases, the purchaser will want to publish the final report/study (with its logo or within its working materials), without retaining the copyrights. In that case, the report/study has to be freely available to the general public, so that it remains outside the VAT domain. This implies that the authors could continue submitting the study for publication in other places (for instance, in international peer-reviewed journals), which is a standard practice in the scientific and research activities. Only then will the international journal require that the author transfers the copyrights to the journal, which constitutes a contract falling under the VAT system (although, such contracts usually do not generate royalties for the author, therefore the VAT amount will be zero). Unlike this practice, if the purchaser uses the report/study exclusively for his/her own internal purposes, and/or publishes the study exclusively for commercial purposes (sells it), then the royalty paid for the study will be considered a consultancy fee and will fall under the VAT system.

We provide an illustrative example below.

#### **VAT for natural persons and copyrights (authors and artists) in Belgium**

To be liable for VAT in Belgium, the following conditions must be met:

- 1) The artistic work/practice is part of an **economic activity**;
- 2) The services provided or goods supplied are **described in the law**;
- 3) The artistic work/practice is **performed continuously, with a certain regularity**;

**In Belgium, the VAT concerns natural persons creating authorship works only when there is a transfer of copyrights.**

The transfer of copyrights usually occurs within publishing contracts, or a contract whereby the copyrights are transferred to a publishing company that will supply goods or services and make profit from the sale of an authorship work. In that case, there is a VAT exemption. However, it is important to meet three conditions: 1) the author has to be a natural person (the exemption for authors or composers applies only if they are natural persons, but not if they are legal entities); 2) the publisher has to be a third party (a contract is concluded between an author and a publisher, but not between two publishers); and 3) a publishing contract has to exist involving copyrights and the realisation of rights of multiplication (e.g., books) with an obligation to publish the work.

In transfer of copyrights within another contract, when the above-mentioned is not met, the VAT rate is preferential, namely 6% (instead of a 21% rate).

Also, apart from the VAT Code, where the VAT exemptions are listed, Belgium has a set of clear instructions specifying the exemptions. For instance, when there is an exemption in the area of education, then a clear description is provided of what constitutes an educational service, but also details on whether, for example, organising workshops is part of the educational services or not, what are the workshops (depending on when they are held, are they part of a curriculum, etc.). (Listed as Instructions No.19)

\*Excerpt from <https://www.kunstenloket.be>, VAT on the transfer of autorship or accompanying rights

### 4.3. Contracts falling within the VAT system

Despite the general exemption of authorship contracts from the VAT system, nevertheless some purchasers could conclude an authorship contract not meeting the principles stated above, i.e. when there is transfer of the copyrights to the purchaser, and when only the purchaser is entitled to enjoy the benefits from the authorship work, or when the authorship work could bring the purchaser a commercial benefit through its sale. In general, such contracts concern:

- Management, IT and legal consultancy and business process advice;
- Collection of statistical data (for instance, through surveys, interviews, etc.)
- Market research and opinion polling;
- Developing computer software;
- Testing and analysis of materials, components and processes.

In their nature, the previous activities **involve authorship component, but of a consultancy type**. Hence, it is recommended that they should not be concluded as authorship contracts, but as **service contracts** (consultancy contracts, contracts for service delivery). They are mentioned in the Commission versus Germany Case C287/00 as contracts falling within the scope of VAT.

### 4.4. Purchasers of authorship contracts falling outside the VAT system

The discussion in sections 4.1 and 4.2 pointed to the standard regulations, practices and principles according to which the **authorship contracts do not fall under the VAT system**. According to the Irish tax administration, it is not particularly necessary to go in depth reviewing these principles because, in practice, the contracts concluded with international institutions and organizations, state and municipal agencies, universities, civil organizations and organizations in the field of culture and arts is likely to fall **outside the scope of VAT**, compared to the contracts concluded with the industry and companies. Therefore, authorship contracts in which the purchasers are international organizations (the World Bank, United Nations Agencies, etc.), ministries and state

agencies, but also universities and non-governmental organizations, which are by definition outside the scope of VAT, will be outside the VAT system.

However, whether the authorship contracts will fall under the VAT system must be decided **on a case by case basis**, in accordance with the above principles. What is particularly important is what they imply and whether the work produced/service delivered will be for the general public good (available for free, in the public domain) or only for the benefit of the purchaser. In addition, the opposite also applies: there will also be consultancy contracts (although very few) bringing a benefit for the general public good and as such they will not fall under the VAT system.

In this section, we note that contracts concluded within the projects of the **EU's Instrument for Pre-accession Assistance (IPA)**, and within projects concluded with international governments and organizations having a special agreement with the Republic of Macedonia for VAT exemption, are exempted from VAT payment<sup>14</sup>. In that case, a natural person – VAT taxable, who was hired as an author or consultant on a project carried out by the purchaser within IPA, has to issue an invoice through the system of the Public Revenue Office. This, inter alia, indicates that ex-post taxation of these contracts of the individuals with VAT is problematic from a practical aspect, or it implies that these contracts will automatically be exempted from VAT taxation, regardless if they are of authorship or other nature.

At the same time, such practice should also include details on the methods and process (instructions) of how the natural person - service provider or author, who is also a VAT payer, should proceed in order to use the exemption, and what should the legal entity that is an implementer of the projects within IPA provide, **while taking into account the need of adequate verification systems by the PRO without additional administrative costs for the taxpayers or for the administrative capacities.**

Also, the VAT exemption applies to contracts for hiring of independent i.e. self-employed and VAT payers who are natural persons and are hired for activities through the Horizon 2020 Programme (EU Programme for Research and Innovation). VAT Exemption Certificate is issued to H2020 experts who are

---

<sup>14</sup> Framework Agreement between the RM and the EC on the arrangements for implementation of union financial assistance to the RM under the Instrument for Pre-accession Assistance, Article 28, Official Gazette of RM, 99/2015.



taxpayers in accordance with the national legislation in an EU Member State, who are natural persons and are directly hired via a contract. **“If you are considered to supply a taxable service under national tax law and you are registered for VAT as a natural person in an EU Member State, you can benefit from a VAT exemption certificate for payments made under your contract<sup>15</sup>”** The request for this certificate is submitted by registering on a special expert portal and/or via an email address by listing the details for registration, i.e. the contract whereby the person was hired.

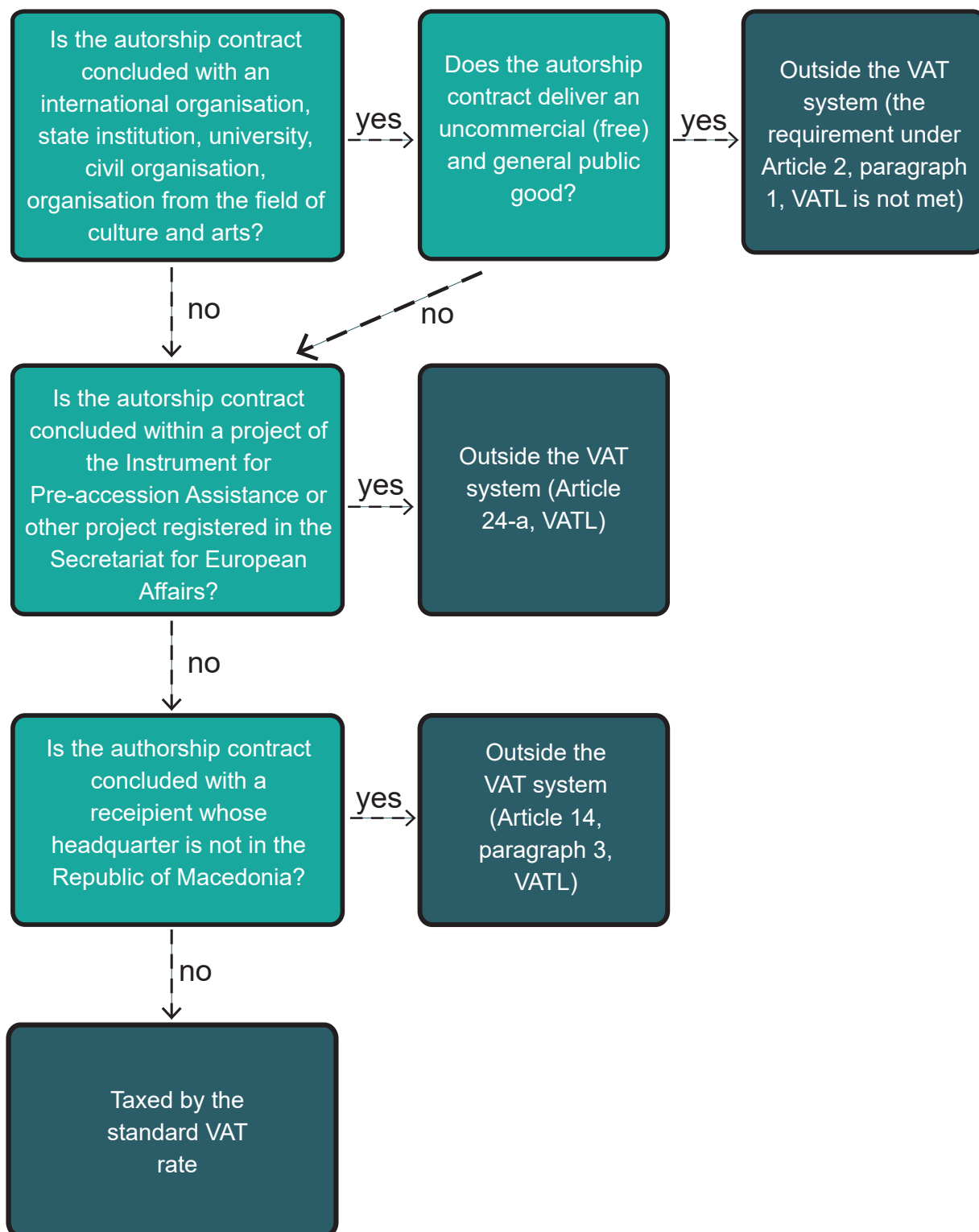
Contracts of natural persons delivering a service to a firm/organization located **abroad** are also not subject to VAT, regardless if they are of authorship or other nature. Namely, according to Article 14 of the VAT Law, the place of supply of services shall be the place where the supplier of services has his headquarters, a branch office or residence from where the services are physically supplied. However, in the case of authorship and related rights (but also legal, economic and similar consultancy services), the place of supply of services shall be the place where the recipient of the service for whom the service is physically carried out has physical headquarters, branch office or residence.

\*\*\*

---

<sup>15</sup> [http://ec.europa.eu/research/participants/docs/h2020-funding-guide/experts/contracting-and-payments\\_en.htm](http://ec.europa.eu/research/participants/docs/h2020-funding-guide/experts/contracting-and-payments_en.htm)

The following chart is an overview of the treatment of authorship contracts for natural persons in the VAT system:



Source: The authors, based on the discussion in this study.

## 5. Conclusions and recommendations

The purpose of this policy study is to support the thesis that only clear, precise and unequivocal legal solutions, accompanied by impartial and non-selective application, could be the foundation for the rule of law. The study treats the issue of VAT for individuals as an issue of the rule of law.

**The VAT Law, in its current form, does not allow a legal basis for wide and general application of the provisions for taxation of natural persons, thereby undermining the rule of law, principally because:**

- **The Law defines the independent business activity in a general sense, which, in the parts concerning natural persons, is in full contravention with the provisions under the Law on Personal Income Tax and the Company Law;**
- **The Law does not define what constitutes the continuity of a business activity;**
- **The Law makes no distinction between contracts not involving a supply of services by legal entities (usually, grant agreements) and contracts not involving a supply of services by natural persons (usually, authorship contracts), while the tax authorities publicly expressed their intention to include the latter in the VAT system.**

Hence, this policy study gives the following recommendations, completely and unequivocally for the purpose of establishing and strengthening the rule of law in the domain of the implementation of the VAT Law:

- The VAT Law should further specify the **business activity**, and should also accurately define what independence in carrying out the business activity is. The independent business activity should be harmonized with the other laws, such as the PIT Law and the Company Law;
- Open and keep a **Register of natural persons – VAT payers**. The register could be designed according to the International Standard Classification of Occupations (ISCO-08). Each individual, when registering in the register, will designate his/her principal business activity.
- The legislator should define what constitutes **continuity in performing the business activity**, by determining the number of transactions for a

particular business activity that would be considered as continuity. Therefore, the requirement for being entered in the register would not only include the VAT threshold, but also the number of transactions in a given period;

- The further specifying of the VAT Law **should contain provisions whereby the authorship contracts outside the scope of VAT will be easily identifiable**, or to prescribe at least that those are contracts where: 1. The purchaser is not a direct user of the authorship works produced; 2. The authorship works are freely available to be used by interested parties and the public; 3. The remuneration for the authorship work is not determined per market value unit of the intellectual labor; 4. There is no commercial benefit for the purchaser.
- To more easily distinguish the authorship contracts falling outside the scope of VAT from the contracts involving consultancy components, it is recommended that in the future the **authorship contracts contain a clause of the following type**: *The authorship work produced within this contract is for non-commercial purposes and will be freely available to the general public.* In addition, those contracts where the purchaser will refuse to include such a clause will fall within the VAT system by default.
- Develop a **rulebook and guidelines on the services provided by natural persons within the liberal professions that constitute a VAT taxable supply, on the costs and their** distribution for VAT deduction.
- Develop a clearly defined rulebook and procedures for the issuance of **certificates** for hiring individuals providing services for activities relating to **natural persons** that confirm the VAT exemption and for the purposes of projects exempted from VAT, such as IPA and H202, and other donor projects.

## 6. References

1. American Institute of Certified Public Accountants, 'Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals', (AICPA, 2017), <https://www.aicpa.org/ADVOCACY/TAX/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf>
2. Commission staff working document the Former Yugoslav Republic of Macedonia Report 2015, European Commission, [https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/key\\_documents/2015/20151110\\_report\\_the\\_former\\_yugoslav\\_republic\\_of\\_macedonia.pdf](https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/key_documents/2015/20151110_report_the_former_yugoslav_republic_of_macedonia.pdf)
3. Company Law, Official Gazette of the Republic of Macedonia No.28/04 dated 30.04.2004 and its amendments.
4. [http://ec.europa.eu/research/participants/docs/h2020-funding-guide/experts/contracting-and-payments\\_en.htm](http://ec.europa.eu/research/participants/docs/h2020-funding-guide/experts/contracting-and-payments_en.htm), seen on 30.7.2018
5. <http://www.finance.manchester.ac.uk/corporatevat/vat/vatformsandguidance/vatguidanceforresearch/>, VAT Guidance for research, seen on 30.7.2018
6. <http://www.marcusward.co/vat-taxable-supply-basic-definition/>, seen on 06.08.2018
7. <https://info.lse.ac.uk/staff/divisions/research-division/Assets/Documents/Word/accounting-for-vat-for-research-lse-updated-march-17.docx>, seen on 17.7.2018
8. <https://www.kunstenloket.be>, VAT on the transfer of authorship or accompanying rights, seen on 30.7.2018
9. <https://www.vero.fi>, Finish Tax administration, 06.08.2018
10. [https://www2.le.ac.uk/offices/finance/information-for-staff/financial-operations/tax\\_incl\\_vat/research-vat-guidance](https://www2.le.ac.uk/offices/finance/information-for-staff/financial-operations/tax_incl_vat/research-vat-guidance), seen on 06.08.2018
11. Judgment of 11 November 2014. *CCE v Morrison's Academy Boarding House Association [1978] STC 1*, FTC/52/2013. Upper Tribunal.
12. Judgment of 13 June 2002. *Keeping Newcastle Warm*, C-353/00. ECLI:EU:C:2002:76.
13. Judgment of 18 December 1997. *Landboden-Agrardienste v Finanzamt Calau*, C-384/95. ECLI:EU:C:1997:433.
14. Judgment of 20 June 2002. *Commission v Germany*, C-287/00. ECLI:EU:C:2001:699.

15. Judgment of 29 February 1996. *Mohr v Finanzamt Bad Segeberg*, C-215/94. ECLI:EU:C:1995:405.
16. Judgment of 3 March 1994. *Tolsma v Inspecteur der Omzetbelasting*, C-16/93. ECLI:EU:C:1994:16.
17. Judgment of 8 March 1988. *Apple and Pear Development Council v Commissioners of Customs and Excise*, C-102/86. ECLI:EU:C:1987:466.
18. Law on Authorship and Related Rights, Official Gazette of the Republic of Macedonia No.115 dated 31.08.2010 and its amendments.
19. Law on Personal Income Tax, Official Gazette of the Republic of Macedonia No.80/93 and its amendments.
20. Law on Value Added Tax, Official Gazette of the Republic of Macedonia No.44/99 and its amendments.

Appendix – Definitions from legislations in other countries

	<b>Taxable person</b>	<b>Private persons</b>
Belgium	Any person (1) who in the exercise of his or its economic activity (2) in a regular (3) and independent (4) manner, with or without profit motive (5), on a principal or an accessory basis (6), supplies goods or services referred to in the VAT law	Private persons are not taxable persons except in the case of the intra-Community supply of a new means of transport or the supply of a new building or a “real right” on a new building
Bulgaria	Anyone who carries out an independent economic activity, whatever the purpose or results of that activity	Private persons employed under a labour contract, or a contract establishing equivalent rights and obligations to a labour contract, are specifically excluded from the scope of the term “taxable person” as their activities are not regarded as independent economic activity. The activities of private persons (other than sole traders) engaged in the management and control of legal persons, as governed by law, also do not represent independent economic activity and, thus, these persons are not considered taxable persons for the said activities.
Germany	Anyone who independently carries on a business or professional activity	
Estonia	Individuals, legal entities, public bodies and institutions engaged in business activities in respect of which they are or must be registered for VAT purposes	
Spain	A taxable person (entrepreneur) is defined as a person or entity that organizes for its own account (and, therefore, independently) material and/or human factors of production with a view to participating in the production or distribution of goods or services	
Finland	A taxable person is the person who supplies goods or services subject to VAT as a business activity within Finland, imports goods into Finland or makes intra-Community acquisitions in Finland	
France	Any person who independently carries out an economic activity	
Croatia	Anyone who independently carries out an economic activity	
Italy	Persons who fall within the scope of VAT emerge from the various legislative provisions relating to taxable transactions and the obligations of those who make taxable supplies	
Netherlands	Anyone who independently carries on a business activity	
Slovenia	Anyone who independently carries on any business activity in any place, irrespective of the purpose or result of the activity	



# Individuals in the VAT system and the rule of law in Macedonia

With a special reference and recommendations concerning authorship contracts

