CORPORATE TAX INCENTIVES IN TRANSITORY ECONOMIES: CASE OF THE REPUBLIC OF SERBIA AND REPUBLIC OF MACEDONIA

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Abstract

Tax incentives are one often used tool by low-income countries for attracting capital and money into their economies. Usually, formerly closed economies during their transition to open-market economies use different forms of tax and other types of incentives to attract foreign companies and their capital to be placed into these economies. The case of the former Yugoslav republics, Serbia and Macedonia, is an interesting example of incentives established with the aim to reconstruct and rebuild industry and infrastructure, to get better welfare, etc. Of the various incentives in the pool, tax incentives are used the most. The authors of the article analyze the policy of corporate tax incentives in the Republic of Serbia and Republic of Macedonia since 2000, which have been changing in forms and scope as a consequence of the Serbian/Macedonian tax system's reform. The authors stressed differences between the two countries, which are mostly influenced by the negotiation process with European Union and the need to harmonize national legislation with European Union rules: in Serbia tax incentives in the sphere of corporate taxation were very generous at the beginning of the period; the similar situation was in Macedonia. However, after the negotiation process between the European Union and Macedonia was "frozen" in 2005 and the negotiation and accession process with Serbia has been opened, the situations in these countries have become different: the tax incentives' policy in Macedonia stayed generous comparing with Serbia which had to be narrowed because of the European Union pressure (to avoid being accused of harmful tax competition).

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1 INTRODUCTION: TAX INCENTIVES IN TRANSITORY ECONOMIES

Although tax incentives as measures to attract Foreign Direct Investments (FDIs) are narrow measures (Nikolov & Bogov, 2003) and highly criticised by tax experts (Easson 2004) they are often used in developing countries and transitory economies to attract capital and increase economic activity. The tax incentives' policy of transitory economies has different characteristics than the policy applied by developing countries, which is a consequence of the difference in social and economic conditions, geographical and political environment, culture, heritage, etc. and the gravity of the European Union (EU), the accession road to the EU, and the potential of the EU transformative power. These EU related factors have probably the most important influence over transitory economies. These economies are *per definitionem* economies undergoing the transition from planned to efficient market economies. Most of them are in South-East Europe (SEE) as countries born after the breakup of large socialist countries (Czechoslovakia, FR Yugoslavia (FRYU)) or just after the breakup of the socialist regime in unitary countries (Hungary, Poland, etc.). In conjunction with a closed economy, socialism almost completely ruined free economic activity in these countries: infrastructure was in poor condition, production was at a very low level, the high level of unemployment related to low living standards caused corruption and degradation of the institutions and legal order. (Nikolov, 2004). After the demise of socialism, the new/old countries found themselves in a peculiar situation – they were in desperate need of capital, had depreciated infrastructure, and needed to reconstruct the whole economy. The geographical location of these countries (in Europe) placed additional pressure on the newly born economies – the EU's transformative power and the majority support from citizens to become a part of the developed community influenced SEE countries to introduce different forms of incentives to attract foreign investors and foster economic growth. Having in mind that a tax burden often has a decisive influence on investment decisions, transitory economies took the approach of establishing a generous policy of tax incentives for FDIs. However, the accession and negotiation process with the EU has changed the chosen approach. One may separate the policy of tax incentives in SEE countries into three phases: (1) phase after the breakup of the socialist regime, but before the implementation of the Stabilisation and Association Agreement (SAA); (2) phase when the SAA went into force and began to be implemented (during the negotiation process); and (3) phase when the country received EU membership. Countries that have already entered the EU (Slovakia, the Czech Republic, Hungary, Slovenia, Poland, Croatia, etc.) have passed the first two phases and are currently in the third phase.

The situation of the Western Balkan countries – former FRYU republics – has specificities that separate them from other transitory economies: the collapse of the FRYU, the UN blockade, and the civil war in the 1990s strongly hit those economies and slowed or almost completely stopped their transition and initiated reforms. As the countries that are still outside of the EU, the Republic of Serbia and the Republic of Macedonia are in different positions. The negotiation process with Serbia is currently ongoing, while the Republic of Macedonia has been in the pre-accession stage since 2005; its process has been "frozen" because Greece has complaints concerning the name of this former YU republic. As nationals and citizens of Serbia and the Republic of Macedonia, the authors of this paper analyze the policy of tax incentives in their own countries from the aspect of the abovementioned phases, comparing the taken approach and view of the future path.

The first part of the paper deals with the policy of granting tax incentives in Serbia, taking into account the phase before the opening of the negotiation on accession with the EU and the current phase – after beginning the implementation of the SAA and opening negotiation. The second part of the paper represents an overview and analysis of the tax incentives' policy in the Republic of Macedonia. In the third part, we illustrate and summarize FDI and state aid experience for Serbia and Macedonia, and finally, we present our conclusions.

2 SERBIA

The breakout of civil war in Bosnia and Herzegovina and the introduction of economic sanctions for Yugoslavia in 1992 by the United Nations slowed and almost stopped the process of fiscal and tax reform that started simultaneously in Serbia and Montenegro. (Stojanović, 2002) This was a very difficult period for both republics, but as the authors of this paper are focused on Serbia (without Montenegro), only the situation and related consequences of this country are taken into consideration. Although tax reform was slowed down, certain changes were made in 1995 in the sphere of corporate taxation (which is of major importance for FDIs). (Stojanović, 2002) However, these were paradoxical changes that canceled all undertaken reformatory steps and returned the whole Serbian tax system to what it was in the period before 1992. The situation in the 1990s was bad for the whole country and consequently for the tax system; investors circumvented Serbia as well as other former Yugoslav republics as unpopular destinations for the investment of capital. The curse was broken after the fall of the political regime that marked the 1990s. Political changes in October 2000 brought on a positive change in how other countries viewed Serbia, which resulted in the granting of funds for conducting reforms in different sectors. Again, Serbia found itself on the transition road trying to repair the damage of "lost time" and stopped reforms.

2.1 Tax incentives as part of tax reform (the period from 2001 to 2013)

"New" fiscal and tax reform started in 2001[1]. (Popović, 2001) All tax forms were reformed, although the process of reform is still ongoing. The undertaken changes brought these forms closer to the forms that exist in open market economies. Taking into consideration that foreign capital and investors mostly pay attention to the corporate tax burden (because the owners of the biggest capital are multinational corporations), for them the most important changes were those made in the sphere of corporate taxation. The law prescribed significant tax incentives as the measures that would encourage the arrival of "fresh" capital into the Serbian economy. The list of tax incentives consisted of three general forms: (1) accelerated depreciation, (2) tax exemptions, and (3) tax credits. Accelerated depreciation of fixed assets shortened the period of the productive use for purposes such as environmental protection, research, education and training, and computer equipment. Although accelerated depreciation was used a lot by all companies, the two other forms (tax holidays and tax credits) had greater importance for foreign investors. Tax exemptions were granted in several situations:

- to a non-profit organization that declares income up to a certain (prescribed) number of RSD higher than its expenditures in the year for which the right to exemption is granted, under the conditions prescribed by the law;
- in the case of concession-related investment, the concession-receiving enterprise or concessionaire owning an enterprise registered for engagement in concession-related activities is exempted from tax on the profit earned on the basis of the income stemming from the subject matter of concession up to five years from the contracted date of completion of the concession-related investment;
- an enterprise engaged in vocational training, professional rehabilitation, and employment of disabled persons is exempted from the payment of the corporate profit tax, in proportion to the share of such persons in the total number of its employees.

As with tax exemptions, legislators prescribed a list of situations when tax credits could be granted. According to the law, a taxpayer is entitled to a tax credit in the following situations:

[1] It was a continuation of the reform started in 1992, interrupted during the period of civil war and economic sanctions introduced by the UN. Having in mind that political and other conditions in Serbia had been changed in the meantime, fiscal reform initiated in 2001 was not only a return to the goals and tasks established in 1992, it also added new tasks for the Serbian government and, accordingly, for the Ministry of Finance. During the spring of 2001, completely new tax laws were adopted, which was the first step of the comprehensive tax reform in Serbia.

- a taxpayer who has generated profit in a newly established operating unit in an underdeveloped region (defined in accordance with the regulations dealing with regional development or identifying underdeveloped regions) is entitled to a corporate profit tax reduction in a period of two years, in proportion to the share of such profit in the total corporate profit;
- a taxpayer who invests in his or her own fixed assets serving for the conduct of his or her registered business is entitled to the reduction of the tax calculated for the year when the investment was made (tax is to be reduced by up to 10% of the investment);
- a taxpayer who employs new workers for an undetermined period is granted a reduction of the calculated tax equal to the amount of 40% of gross salaries paid to those workers plus public revenues paid by the employer; the reduction is granted for a period of two years starting the day of employment if other prescribed requirements are satisfied;
- a special form of the tax credit was prescribed for small enterprises, which were entitled to tax credit from 40% of the investment in fixed assets, which may be up to 70% of the tax calculated for the year when the taxpayer made the investment.

Up until 2013, when the SAA signed between the EU and Serbia went into force, the prescribed forms of tax incentives had been changing in the direction of enlargement and growth. Serbian legislators canceled some of them (e.g. tax credit for small enterprises), enlarged others, but also introduced completely new incentives. Certainly, the most significant change during this period was the establishment of tax incentives exclusively for the purpose of attracting investors. Legislators introduced new incentives that were granted if prescribed conditions had been fulfilled. Actually, these incentives had a form of tax holidays granted for a certain period (five or 10 years) depending on: the sum invested into fixed assets; employment of a determined number of new workers; if the investment had been made in assets located in an underdeveloped region (or region of special interest for the Republic of Serbia); etc. There were two types of investment incentives: an incentive for “big” investment and incentive for “small” investment and, accordingly, “big” and “small” tax allowances. At the time when these incentives were introduced, the required amounts entitling a taxpayer to a tax allowance were 600 million RSD and 6 million RSD. (Stojanović, 2010)

- In the first case, a taxpayer was granted a tax allowance for a duration of ten years starting the year when the first profit was earned. The allowance comprised freedom of tax payment in proportion to the amount invested in fixed assets. The prescribed number of new workers that had to be employed for an indefinite period was 100, and the investment needed to be made in assets used for businesses registered in Serbia, etc.
- The second form of investment incentive comprised an amount of 6 million RSD invested in fixed assets used in business conducted in an underdeveloped region (at least 80% of these assets needed to be used in this region) in conjunction with employment of at least five new permanent workers who are permanent or temporary residents of the concerned underdeveloped region (at least 80% of permanent employees). The allowance in the proportion of the invested sum could be granted for a period of five years starting the year when the first profit was earned.

The amount of the investment needed to be granted one of the above tax allowances had been changing: instead of 600 million RSD, the law prescribed an amount of 800 million RSD, and instead of 6 million RSD, the new prescribed amount was 8 million RSD. The same year when the amounts were raised, the incentive in the form of accelerated appreciation was canceled, and the tax exemption for non-profit organizations comprised a higher amount of the declared income (instead of 300,000 RSD, the new requirement was 400,000 RSD). However, lifting the required treasury was not a consequence of the sharpening conditions that investors should fulfill; it was a consequence of inflation. The same is the case with the establishment of “big” and “small” investment incentives – in the view of the authors of this paper, the main reason that influenced the Serbian Government and legislators to introduce two types of tax holidays exclusively for investors was the desperate need for funds to recover ruined infrastructure and revive the almost "lifeless" industry. However, funds were cut off in the whole world, which was strongly hit by the global economic and financial crisis. During 2007 and 2008, several financial scandals broke out in the United States (US) and almost destroyed the banking and stock exchange markets. From the US, the crisis rapidly spread out to other developed economies around the world and, consequently, to other developing and transitory economies. It is interesting to note that the global crisis hit Serbia and Macedonia not through the financial channel, but through the trade channel. Since Germany and Austria are the biggest trade partners of Serbia and Macedonia, and both countries were faced with a shortage of demand for their goods and a shortage of funds, the Serbian Government decided to design a new set of tax incentives with the aim to attract investors and "fresh" capital.

Probably with the same intention, Serbia lowered the statutory tax rate from the initial 20% (in 2001) to 15%, and afterward to 10%. Although the low statutory tax rate is not tax incentive in the real sense of the word, its existence may be a good "signal" to investors when making a choice on investment location. (Stojanović, 2017) Actually, instead of a low statutory tax rate, investors "look" for an effective tax rate, which shows the real tax burden; it could happen that in conjunction with tax allowances, a higher statutory tax rate results in a lower effective tax burden of investment when comparing to a situation in which the statutory rate is low, but tax allowances do not exist or are narrow.

In this period, the network of Double Taxation Treaties (DTTs) inherited from the former FRYU numbered around 50 DTTs. The rates established for withholding tax on passive business incomes (dividends, royalties, and interest) were very beneficial in DTTs signed with countries such as Germany, Norway, Sweden, China, the Netherlands, etc. (Stojanović 2016) which invest a lot in Serbia and where many Serbian nationals are working temporarily.

The Law on foreign investments adopted in 2002 was asymmetric in its treatment of domestic *versus* foreign investors. Namely, according to the rules of this act, only foreign investors were entitled to prescribed allowances, whose lists were more than generous. In 2006, the Regulation on conditions and method to attract direct investments was adopted. The Serbian Government had the intention to attract significant capital into the Serbian economy to remove and improve production, increase the employment rate, equalize territorial development, and transfer new knowledge and technologies. According to the Regulation, the special incentives were prescribed for investments in the car industry, electronic industry, and the IT industry. It is interesting that in this act, the Government prescribed a norm according to which special funds for attracting direct investments are provided in the national budget. An amount between 2,000 EUR and 10,000 EUR was granted to investors depending on the type of investment and its effects. Furthermore, funds were provided for investments of "special importance for the Republic of Serbia", when an investor could be granted funds without the obligation to return them.

As is the case when one country grants generous incentives for investments, instead of attracting significant capital that would improve economic growth and living standards, the Serbian Government was faced with adverse effects – high budget expenditures without satisfactory results. Bad experience together with conditions prescribed in the SAA influenced the Serbian Government to change the policy of granting tax and other incentives for investments.

2.2 Influence of the SAA and negotiation with the EU

After the SAA went into force and the date of opening the negotiation on accession was approaching, the Serbian Government was under pressure to be more accurate in harmonizing Serbian legislation with EU standards and *acquis communitaire*. Further pressure was coming from the Code of conduct for business taxation (here and after Code of conduct) adopted in 1997 and the political statement of EU member states to undertake measures against harmful tax competition and to refrain from introducing any measure that would harm fair tax competition in the Internal Market. Before the Code of conduct was adopted, a group of experts made a *Ruding report* identifying certain measures as potentially harmful (the existence of tax incentives and a low statutory and effective corporate tax rate were on the list). (Commission of the European Communities, 1992) Signing the SAA, Serbia obliged itself to commit to the rules of the Code of Conduct and to cancel all the measures that potentially create harmful tax competition. The first step undertaken by the Serbian Government in the sphere of corporate taxation was lifting the statutory tax rate – instead of 10%, in 2013 the rate was lifted to 15%. Furthermore, numbered forms of tax incentives were canceled. From 2013 to the present day, tax measures aiming to attract investors comprise the following tax incentives prescribed in the Corporate Income Tax Law:

- Tax exemptions for:
  - a non-profit organization that declares income up to a certain (prescribed) amount of RSD, which is higher than its expenditures in the year for which the right to exemption is granted, under the conditions prescribed in the Law;
  - an enterprise engaged in vocational training, professional rehabilitation, and employment of disabled persons is exempted from the payment of the corporate profit tax, in proportion to the share of such persons in the total number of its employees.
- Investment incentive in the form of "big" allowance: under the current solution, the prescribed amount that entitles taxpayers to a tax allowance is one billion RSD (approximately 8 million EUR).

In addition to corporate taxation, incentives prescribed in the Law on foreign investments had also been changed. In 2015, this Law was replaced with the Law on investments. For the first time, foreign and domestic investors were on equal footing, which has been explained as non-discrimination in the treatment of capital regardless of its origin. (Stojanović, 2017) Also, under this Law, the Serbian Government introduced state aid as a subsidy given from the national budget to support investment in the Serbian economy. Taking into consideration that this measure could have harmful effects, the prescribed rules follow EU standards (as stated in articles 107 to 109 of the Treaty on the functioning of the European Union) and have been harmonized with those applied by EU member states with the aim to not disturb the functioning of the Internal Market. The rules prescribed in the Law on investments are, actually, a reflection of the rules established under the Law on State Aid Control, which was adopted in 2009, and related regulations. In addition to state aid, further incentives for investments into the Serbian economy prescribed under the Law on Investments are the following:

- Tax incentives and allowances, as well as exemption from fees;
- Customs incentives (e.g. exemption from customs duties);
- Incentives within the compulsory social security system.

A significant incentive for investments in the Serbian economy is represented by the existence of economic zones. Within the area of such zones, investors (companies and entrepreneurs) are entitled to various benefits: exemption from the Value Added Tax (VAT); customs duties and other charges on the import of goods for production in the zones; no taxes or other charges for the exchange between producers in the same zone or between producers in two zones in Serbia; no VAT on energy consumption for production activities in the zones; free circulation of capital profit, and dividends; efficient administration (one-stop-shop); etc. Currently, 14 economic zones are active in Serbia, which positively influences decisions to invest in Serbian economy and to start operating business within the territory of an economic zone or in some other part of Serbia.

Other significant benefits prescribed in the Corporate Income Tax Law are the following:

- Possibility to carry over losses (the allowed period is five years);
- Withholding the tax rate of 20% for the payment of the determined forms of (passive) income from a Serbian resident to a non-resident (in case of payment, the withholding tax rate is 25% for incomes to residents of the jurisdictions that are "blacklisted" by the Serbian Ministry of Finance);
- Possibility to pay tax under tax consolidation approved for a group of companies-residents of the Republic of Serbia for a period of five years (under prescribed conditions).

In combination with the aforementioned benefits, the network of 58 DTTs makes Serbia highly competitive in relation to surrounding countries. Surely, when comparing to other former Yugoslav republics such as Croatia (which is already in the EU) and Montenegro (which is also in the process of negotiation for EU membership), Serbia is in a worse position because it has no direct access to the sea (Adriatic Sea) as an alternative transport route. However, Europe's biggest river, the Danube, flows through Serbia, which is very important for shipping transport and access to the Black Sea.

At the end, we should stress payroll incentives prescribed in the Personal Income Tax Law (although this is not the last tax incentive within the Serbian tax system). Payroll tax incentives are granted to employers who hire new workers or disabled persons; depending on the number of hired new workers, the employer is entitled to a refund of a certain percent of the paid taxes: up to nine new workers – 65% of the paid taxes; up to 99 new workers – 70%; more than 100 new workers – 75%. In the case of employment of disabled persons, the employer is exempted from the payment of taxes for a period of three years as of the date of employment. The most important condition for the approval of the tax relief under the Personal Income Tax Law is the non-use of any other tax relief prescribed under other Serbian laws.

3 MACEDONIA

As already mentioned in the introduction, one may separate the tax incentives' policy in Macedonia into two phases: (1) phase after the breakdown of the socialist regime and signing of the SAA in 2001 until the granting of the pre-accession status in 2005; (2) phase when the new fiscal paradigm came to power in 2006 with the flat tax regime and the introduction of the various incentives in the Corporate and Personal Income Tax laws.

3.1 Transition, signing of the SAA and getting the status of a candidate country for EU membership

The real transition process began after the breakup of the FR Yugoslavia when Macedonia became an independent state. The most important sphere influenced by the transition and breakdown of the command economy was the sphere of enterprise organization. In 1993, the Macedonian privatization process adopted the Law on the Transformation of Enterprises with Social Capital. However, the tax system had not been so radically changed. Only the introduction of the VAT (which replaced the sales tax) in April 2000 can be considered as a radical change. In the sphere of corporate income tax, the first changes were made after Macedonia became a candidate country for EU accession (December 2005). In 2006, the flat tax regime was introduced in the Corporate Income Tax Law, as well as in the Personal Income Tax Law. Other changes, such as regulations on State Aid control occurred after the European Commission gave its recommendation to the Council, for the first time, for initiating accession negotiations in 2009.

3.2 Start of the flat tax regime and introduction of other corporate income tax incentives

The Government of Macedonia introduced a number of supply-side policy measures at the end of 2006 aiming to reduce the tax burden and improve the business environment. The main pillars of the tax system reform were the elimination of the progressive personal income tax system, the reduction and unification of the statutory rates for the personal income and corporate taxes, and the introduction of the zero tax rate on reinvested profits. The so-called *flat tax* refers to personal income and corporate profits being taxed at one marginal rate (12% in 2007 and 10% in 2008 onwards). Additionally, the Government of Macedonia introduced a 1.5% tax on the gross annual income of micro businesses. (Stojkov, Nikolov & Smilevski, 2008) From the very beginning, it was widely campaigned through the media as a part of the election platform for the governing party at that time. After the parliamentary elections in 2006, foreign investors also became an important segment of the target group. The IMF and a number of independent experts also welcomed such policy.

What were the main driving forces behind tax reform in Macedonia? Desperate for foreign direct investment inflows, burdened with high unemployment, and willing to provide the impetus for vigorous restructuring, the Government of Macedonia decided to design a competitive tax system. Positive experiences from other countries (Estonia, Lithuania, Latvia, Russia, and Slovakia) that had already introduced the flat tax system gave strong justifications for the tax reforms. (Stojkov, Nikolov, & Smilevski, 2008)

At that time the greatest benefit from the flat rate system was the introduction of tax simplicity, replacing the complexity of tax calculations that taxpayers have to go through, which is also supported by survey results. Cutting the tax rates and broadening the tax base hindered the incentives for tax evasion. In return, the fiscal discipline of taxpayers increased as seen by the improved collection of taxes, which makes the flat tax system more efficient. With respect to the level of the tax rate, it seemed unavoidable to envisage a lower tax rate as part of the new tax reform proposals, given the fierce tax competition in the region.

Within the corporate income tax, the most important incentives prescribed under the Corporate Income Tax Law are the following:

- right to be granted a reduction of the tax base for the reinvested profit for development purposes;
- tax holiday (exemption from the corporate income tax) for a period of 10 years for investments in technological development zones.

In contrast to Serbia and other former Yugoslav republics, the current solution in Macedonia is the possibility to carry over the losses for a period of three years. Furthermore, Macedonian Corporate Income Tax Law does not have any provision on tax consolidation, which means that this form of tax allowance is not regulated under the Macedonian corporate tax regime.

Economic zones in Macedonia are currently regarded as Technological Industrial Development Zones (TIDZ). As of 2007 when the Law on Free Economic Zones was superseded by the new Law on TIDZ, these zones have been promoted as a form of attracting FDIs and, pursuant to the law, aim at: "*acceleration of the economic development by attracting foreign and domestic capital for the development of new technologies and their application in the national economy, increasing the competitiveness and employment*." Therefore, companies that are located in TIDZs in Macedonia enjoy significant benefits for achieving their goals: by tax and nontax exemptions (measures for stimulating the investors). These subsidies and exemptions are based on the Law on TIDZ and, additionally, on the right to State Aid as an additional incentive for investors in accordance with the Law on State Aid Inspection.

According to the Law on TIDZ and the Law on State Aid Inspection, there are more types of tax exemptions and additional incentives for foreign companies, the beneficiaries of TIDZs in Macedonia. Macedonia, as mentioned before, offers benefits in the form of exemptions and State Aid through the Law on TIDZ and the Law on State Aid Inspection to those FDIs that are beneficiaries of TIDZs. The exemptions and incentives that the Government offers for the companies in TIDZs appear in the following forms (CEA, 2016):

- Tax exemptions from the corporate income tax: the beneficiary of the zone is exempt from paying the corporate income tax for a period of 10 years. The profit tax rate in the Republic of Macedonia is 10%. The tax rate is applicable in the case of an allocation of the profit in the form of a dividend.
- Tax exemptions from the personal income tax: the beneficiary of the zone is exempt from paying the personal income tax on the basis of wages of the employees in the period of 10 years, regardless of the number of employees.
- Subsidising for the rental of land: the beneficiaries of TIDZ pay significantly lower rent given the area of the parcels.
- Grant for construction: the amount of aid for construction in TIDZ is limited to 0.5 million EUR, and the companies - beneficiaries of the zones - use this aid in the form of a grant.
- Exemptions from compensation for organizing construction land (communal fees): exemption from compensation, which is local compensation, determined by the municipality on whose territory TIDZ is located.
- Aid for the training of employees: the beneficiaries of TIDZ can receive aid in the form of a grant for training employees in the

amount of 50% of the respective training costs.

- Exemption from paying the VAT: the beneficiary of the zone is exempt from paying the VAT for goods and services in TIDZ (except the profit intended for final consumption) and export of goods in TIDZ (provided that the goods are not intended for final consumption).
- Subsidising 50% of the gross wage of employees for a period of two years: this aid is an alternative for the 50% out of the justified investment costs (for investments up to 50 million EUR), which are evaluated either as justified costs for the investment or as costs for the wage of employees in a period of two years.

It is interesting that in Macedonia there currently exist 15 economic or technical development zones, of which only three are fully operative (two in the capital city and one in the largest town in Macedonia, Stip). Other zones are in various stages of development.

The existence of the zones in conjunction with 33 DTTs (currently in force) and 27 investment protection treaties makes Macedonia attractive for foreign investors, especially those coming from countries that are the biggest investors in Macedonia (the United States, Germany, and Italy). Furthermore, withholding tax rates prescribed in DTTs on passive business incomes received by non-residents is very beneficial (dividend rate mostly varies – 0%, 5%, 10%, and 15%; interest rate is usually – 10% and 15%; royalties rate – 0%, 5%, and 10%). Although the United States is the biggest investor in Macedonia in TIDZs, no DTT or protection investment treaty between Macedonia and this country have been signed. (

4 CONCLUSIONS

After the breakup of the FRYU, former Yugoslav republics, Serbia and Macedonia, took different paths in building their economies. Both countries have been trying to attract as much capital as possible to increase the living standard of their citizens and to better position themselves in international economic flows. However, the period of the planned economy put both countries in a difficult situation. Each started with various reforms: reforms in some sectors moved faster, but slower in others; some reforms gave significant results, others did not; some reforms faced many problems and were disrupted, etc. Tax reforms in Serbia and Macedonia have a different path, although both countries are former Yugoslav republics with EU membership aspirations. However, Serbia has an advantage because it has already started the negotiation on EU membership; negotiation with Macedonia has not even been opened because of problems with its official name. Tax reform in Serbia that started during the 1990s was interrupted by the breakup of the FRYU. It restarted at the end of 2000 and is currently ongoing. Reform addressed almost all tax forms. The personal income tax has been changed a lot - although the income tax system is still in force, it is now combined with global income tax applied only to residents and non-residents earning income above the prescribed amount. Corporate income tax has been changed much more: the statutory tax rate was changed several times since 2000; transfer pricing regulation was reformed in accordance with international and EU standards; other current anti-avoidance rules were sharpened and some new ones introduced (e.g. list of jurisdictions whose residents are taxed with withholding tax at a higher rate, etc.); various tax incentives were introduced (some of them are still in force, others have been cancelled). Important reform took place in the sphere of consumption taxation when the retail sales tax was canceled and replaced with the VAT; the tax administration was reformed, etc. Notably, in both landlocked countries, the price competitiveness with narrow measures for attracting FDIs was prioritized against the wider measures for attracting FDIs.

In comparison to that of Serbia, tax reform in Macedonia was not that dynamic. Up until now, only a few changes have been made (e.g. replacement of the sales tax with the VAT; lowering of the statutory tax rate of corporate income tax and personal income tax; transitory phase with flat tax regime, etc.). Having in mind the EU accession road of both countries, the above-mentioned differences are understandable. Although Serbia is currently negotiating with the EU on membership and the negotiation process with Macedonia has been blocked, both countries are trying to attract foreign and domestic capital, which is the reason for introducing corporate tax incentives. Different positions of these countries in relation to the EU caused different policies of tax incentives: Serbia had to cancel many of those introduced after 2000 (especially in 2006) and to harmonize its legislation with EU standards; Macedonia still has tax incentives that may create harmful tax competition as per the EU standards. This is especially true with the statutory (and effective) tax rates and regulation of the State Aid. In each case, in general, both countries are carrying out reforms in accordance with the ongoing trends in the international and EU environment, especially bearing in mind the changes that will happen in international taxation as a result of the BEPS Project (Base Erosion and Profit Shifting). This is more evident in Serbia than in Macedonia because (as we have already mentioned) Serbia has already started the EU membership negotiations and is under bigger pressure from the EU then it is the case with Macedonia. Last, but not least, both countries have to create tax incentive policy that will take into account EU law and the undisturbed functioning of the Internal Market because once they become EU members, they will need to respect EU rules and fundamental freedoms of EU nationals. Otherwise, they would be accused of harming the Internal Market and, consequently, harmful tax competition.

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