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Macedonian Young Lawyers Association
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HOW TO IMPROVE THE LEGISLATION

that will protect the Civil Society
Organizations from arbitrary inspections
and controls with regards to the taxation

- Recommendations for amending the legislation -



Citizens for change!

Skopje, July 2017

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How to improve the legislation that will protect the Civil Society Organizations from arbitrary inspections and controls with regards to the taxation

- Recommendations for amending the legislation -

INTRODUCTORY REMARKS

This document contains recommendations for improving the legislative regulations of the personal income tax, the external (tax) control, and the authorizations of the prosecution authorities in conducting pre-investigative actions¹. The document is based upon a detailed legal assessment of the conducted inspections and controls upon 21 Civil Society Organizations (hereinafter CSOs') in the period between December 2016 till May 2017. The recommendations resulted from the identified problems faced by CSOs', which are consequence of certain imprecise and vague legal provisions. The recommendations are primarily aimed for clarifying and specifying the existing legal provisions and precisely defining the rights and obligations of the CSOs' in cases when they are the subject of tax inspections and pre-investigation procedures, by regulatory authorities and especially precise regulation of the authorizations of the authorized persons who perform the controls and the pre-investigative actions respectively.

This document has been prepared by the Macedonian Young Lawyer Association, the Coalition All for Fair Trials and the Institute for Human Rights within the action "Legal competence for inspections in civil society organizations" supported by the program CIVICA mobilitas. The recommendations are aimed to contribute in improvement of the legal framework which refers to Civil Society Organizations, as well as increasing their legal certainty in Republic of Macedonia.

The recommendations refer to both amendments of the Law on Personal Income Tax and the Law on Corporate Tax, as well as to provisions that directly regulate the manner of conducting external (tax) control. Therefore, the Law should precisely regulate the obligations of Civil Society Organizations regarding taxes and tax exemptions, which is different from the public sector and for profit entities. Additionally, the project team found certain weaknesses in the legal framework that regulates the work of financial police, as well as the Law on Criminal Procedure.

The document first gives a review of the facts related to the conducted inspections, then it analyzes the legal challenges which arise from the inspections, and finally it presents and elaborate on the recommendations for improving of the legal framework.

¹ Law on Personal Income Tax, Law on Tax Procedure, Law on Financial Police and the Criminal Procedure Law.

The inspections and controls targeting CSOs' in 2016 and 2017

In the period from December 2016 until May 2017, 21 CSOs' were subject to an intensive external control conducted by the Public Revenue Office². Simultaneously, these CSOs' were affected by inspections as well as an obligation to deliver data and documentation to the Financial Police within preliminary procedure conducted by the Public Prosecutor. The subject of control and data collection, although imprecisely defined, was the overall financial performance of these organizations from 2012 until today.

The controls were directed towards CSOs' working on human rights protection, and the democratization of Macedonian society who publicly opposed in several occasions the policies of the then ruling political parties. From the very start of the controls, the affected CSOs' had pointed out that in these situations it was not about regulation or justification of control over which they were obligated, but rather about the directing of pressure and intimidation on them³.

Additionally the controls coincided with parallel public statements by leading politicians that they will start a process of „desorosotization“ of the society, and establishment of a new and more “authentic” civil society⁴, as well as coordinated media attack⁵ and atmosphere of pressures towards organizations and individual activists⁶.

The conducted controls by the Public Revenue Office were performed through direct insight into the financial documentation by the tax inspectors in the premises of the CSOs'. The insight was performed daily, during the whole working hours, in a period of several months. At the same time, the CSOs were requested to copy the entire documentation for period of five years, which represented a significant cost. Besides insight into the financial documentation, the CSOs' were also subject to assessment of their program documents (narrative reports, publications, analysis) although these documents do not directly refer to the so called “facts important for taxation”. For some of the organizations, the type of control that was examined was not relevant for the tax and financial operations, and specific employees were examined for the program's activities.

The collection of data by the Financial Police and the Financial Intelligence Agency by order from the Public Prosecutor at the same time with the controls by the Public Revenue Office, were conducted over the same CSOs' for the needs of the preliminary procedure. Civil Society Organizations and their legal representatives weren't notified in what capacity they required the data and the documents. This process was conducted parallel with the external controls by the Public Revenue Office, so often in the same time both tax inspectors and financial police inspectors would be present at the same time.

² <https://advox.globalvoices.org/2017/02/26/macedonias-ruling-party-is-draining-civil-society-groups-time-and-money/>

³ <https://www.state.gov/documents/organization/265658.pdf>

⁴ <https://monitor.civicus.org/newsfeed/2017/01/31/Maceonia-Soros-funded-civil-society/>

⁵ <https://stopsoros.mk/>

⁶ <http://www.mcms.org.mk/images/docs/2017/izveshtaj-za-ovozmozhuvachkata-okolina-za-razvoj-na-gragjanskoto-opshtest-vo-vo-makedonija-2016.pdf> P. 11

Until the completion of this document, only one organization had public information that fine penalty has been imposed for a committed tax offense, failure to calculate and pay personal income tax for donated humanitarian aid (school supplies). In other organizations, controls and inspections had been finalized, but there was still no information about their sanctioning.

On 30 May 2017, a representative of the Anticorruption Commission of Republic of Macedonia publicly stated that the Commission initiated the controls and she requested action by the Public Revenue Office and the Public Prosecutor's Office.

The weaknesses of the legal framework revealed by the conducted inspections

The inspections and especially the manner in which they were conducted, have raised several issues related to the quality of the legal framework that refers to the tax obligations of the CSOs'. The vague definitions and internal contradictions, the insufficiently precise distinction of the taxation of profit from the taxation of non-profit organizations, and in particular the unequal treatment of certain tax inspectors, significantly affected the legal certainty of the civil society. The perceived weaknesses of the legal framework refer to the following:

An unclear and unprecise regulation what is considered as non-monetary income (income in kind) which as such is subject to taxation, and especially whether the hotel accommodation and transport services which CSOs' are providing for the purpose of implementing their own program objectives are contribution in kind and as such taxable.

Lack of a deadline in which external tax control should be finished.

Lack of a clear definition As to what are the legal and factual relations of relevance for taxation in accordance with the subject of external control

The Financial Police has authority that go beyond the authorization determined by Law on Criminal Procedure

Inaccurate proper ambit of the authorizations which the Public Prosecutor has, within pre-investigative procedure regarding the type, scope, conditions, as well as the entitles from which it can collect data and documents.

Recommendations with regards to the tax legislation

Law on Personal Income Tax

Exemption of the non-profit organizations from the obligation to calculate and pay personal income tax for the costs of hotel accommodation, travel and food expenses for the participants (who are not employed by the organizer) for the needs of organizing events (trainings, seminars, conferences, workshops, etc.) when the following conditions are fulfilled:

- (1) The event must be in function of achieving the statutory and program objectives of the organization,**
- (2) The cost must be covered by direct payment from the organization to the companies providers of hotel and transport services, and**
- (3) The event must be appropriately documented.**

One of the essential activities conducted by the CSOs' in order to achieve their program objectives is the organization of various types of events. The events can have different form and purpose varying from trainings where particular target group are being trained on a certain topic, conferences where a debate is opened on a specific issue of public importance, or workshops where some document is prepared (e.g. Strategy). In the implementation of these events the CSOs' incur costs for hotel accommodation, rent of venue where the event is held, as well the cost of refreshment and food for the participants. Bearing in mind that the activity of the CSOs' is oriented towards the community, and towards their constituents participation in these events, most people who attend are not employed by the organization.

The existing legal provisions of the Law on Personal Income Tax, although in an unclear and unprecise manner, establish an obligation for the CSOs' to calculate and pay personal income tax for these costs, regardless of the fact that no financial transfer occurred between the organization and the participant. By applying the possibility given in Article 9 of Law on Personal Income Tax to tax in kind income, the tax inspectors consider the hotel accommodation and transport as certain income which the person received in kind, and the organization as a provider is obligated to calculate and pay tax while the engaged person is obligated to report these incomes in the annual tax statement.

This legal solution, besides being inconvenient for the CSOs', is also incompatible with the very nature of personal income tax. In order to exist an obligation to pay this type of tax is necessary to have a certain income of money, in kind or some other type of income. The participants in these events do not receive any such income. Furthermore, with this solution there is a double taxation for an identical service, first of all the organization is obligated to pay the VAT⁷ on the service (if the project is not exempt from VAT), and then should pay additional personal income tax at the same expense. The implementation of the

⁷Value Added Tax.

events on the other hand is necessary for achieving the organization's program objectives, which in the most cases are in direct benefit to marginalized groups, as well as for the overall democratization of society.

Clear definition and clarification on what can be considered as an income received in kind or in some other taxable form

According to the Law on Personal Income Tax, subject to taxation are all incomes listed in Article 3 paragraph 1 which are received in money, securities, in kind, or another type. The income in monetary form is undeniably taxable. The incomes received in securities are defined in Article 14-a Paragraph 2, as incomes that instead of money they are given in vouchers, cash receipts, stocks. The same article lists the incomes that are realized in goods as objects in material nature. Unlike to the early mentioned less or more clearly defined forms in which incomes that are subject to taxation can be realized, the Law on Personal Income Tax in the same paragraph lists income in some other form having a monetary value as taxable income. With the absence of a clear and unambiguously definition it creates a space for arbitrary interpretation that significantly can affect the legal certainty for the CSOs' as well as the users of the services of the CSOs'.

Law on Tax Procedure

Instituting a time limit in which the external (tax) control must be completed, depending on the scope of the control and the size of the subject of supervision.

The Law on Tax Procedure in the provisions regulating the manner of conducting the external control does not stipulate a maximum time limit in which the control should be conducted. Instead, The Law on Tax Procedure in Article 95 Paragraph 3 states that *the duration of the external control should be limited to the necessary time* without giving any more precise criteria what is considered as *necessary time*. This formulation leaves space for diverse interpretation that can't prevent abuses nor conducting particularly long controls of CSOs'. The prolonged duration of the controls significantly burdens the functioning of the organization during the period of control and it occupies almost the full working hours of the key persons in the organizations.

The time limitation of the control is not a precedent in the Macedonian legislation. The investigative procedure in criminal cases must be completed within 6 months with the possibility of extending for more complicated cases for another 6 months and with upon exemption with additional extension for another 3 months (Article 201 Paragraph 2 of the Law on Criminal Procedure). The misdemeanor procedure must be completed within two months from the day of submitting the request for initiation of a misdemeanor procedure in which is determined fine in amount of up to 15,000 euro and within 3 months for misdemeanors for which is determined a fine penalty in greater of 15,000 euro. Additionally, the Law on Inspection Supervision establishes an obligation for the inspectors to act with caution not to obstruct the efficient functioning of the subject of supervision (Article 10 paragraph 1 of the Law on Inspection Supervision).

Legal definition on the factual and legal relations which are considered relevant for taxation (Article 95 paragraph 1 of the Law on Tax Procedure)

The inspector must assess the factual and legal relations that are relevant for taxation (determination of tax liability and tax assessment). The type and the scope of the specific assessment is determined by the External Control Department according to their own opinion about what is appropriate for what the obligations requires. The scope of these obligations is determined according to the circumstances of each individual case (Article 96 of the Law on Tax Procedure). This legal determination does not clarify or specify at all what is subject of the control. Additionally, it leaves significant discretionary power to tax inspectors in the individual case to determine the subject of the investigation. The lack of precise definition of the notion “facts relevant to taxation”, may lead to tax inspectors asking for information about the work of the CSO that is not relevant for taxation at all, and that can be violation of the right to personal data protection of the participants of a particular event. A clear definition of the facts that are relevant to the taxation (e.g. Number of persons that are engaged, salary, honorary etc) will significantly increase the efficiency, and it will accelerate the duration of the tax control as well as the legal certainty of the entities that are subject to control.

Adoption of a by-law which in a clear and unambiguous way will regulate the obligatory content and the manner of keeping business books and records from Article 45 Paragraph 2 of the Law on Tax Procedure.

The CSOs' as payers of personal income tax are obligated to keep business books and records for tax purposes, if they are regulated by the special tax laws. As business books and records are mean to meant: 1. Accounting documents, records and inventories, annual accounts and financial reports, notes for applied accounting policies and other documents relating to the organization; 2. Business letters and correspondence; 3. Recipes and/or; 4. Other documents, if they are relevant to taxation (Article 45 of the Law on Tax Procedure).

These documents, although common and known among companies, when it comes to non-profit organizations, especially for those who doesn't have a permanent structure, are unknown and complex. There is an absence of clear definitions of their structure, content, and manner of filling as well as the manner of storing and archiving. This can be easily done by a by-law (manual) which will contain rules for storing business books and records for non-profit organizations.

Establishing a maximum limit of costs to which CSO can be exposed in case of external control

The Law on Tax Procedure determines that the costs which are incurred by the subjects for provision of data and documentation are to be paid by them (Article 72 of the Law on Tax Procedure). In practice, when it comes to CSOs', the most common cost is the cost of photocopying and translation of the documentation, which due to the nature of work with

foreign donors, in the most cases is in English. Such costs aren't predicted in the projects, which is why they represent additional cost that can't be covered by the organization.

Restitution of the right to an appeal against tax administrative acts (first instance decisions) of the Public Revenue Office

The amendments of the Law on Tax Procedure from 2015 (Official Gazette of the Republic of Macedonia 154/2015) exclude the possibility of appealing against tax administrative acts, and because of that the administrative dispute is the sole legal remedy. This solution of a direct referral for a persons who believe that their rights are violated by individual acts to an administrative dispute is part from the generally accepted practice of excluding the right to appeal in several procedures in which the administrative authorities make decisions. The basic text of the Law on Tax Procedure determined that the right to complaint against the tax administrative act, and the right to appeal against the decision that was decided upon the complaint, and even then, as a final instance, the right to initiate the administrative dispute (Official Gazette of the Republic of Macedonia 13/2006).

This decision, even though it's within the frames of the Constitution, in practice does not enable timely and appropriate assessment of the legality of the tax administrative act, in regard to the interpretation of certain insufficiently precise provisions of the tax legislation, as well as the actions of the tax inspectors and the responsible persons in the Public Revenue Office. In the appeal process, an administrative body decides, which by rule has experts in the area, rather than the strict legal expertise of the judges. Furthermore, the deadline for rendering the decision about the appeal is 60 days (Article 112, paragraph 1 of the Law on General Administrative Procedures), while such a deadline doesn't exist for deciding an administrative dispute in the Law on Administrative Disputes. In practice, the Administrative Court often happens to act for more than a year, for an issue such as tax this is a significant delay. Additionally, the appeal procedure imposes least strict criteria for meritorious making decisions by the second instance body in comparison with the court. And the court can decide about the essence of the administrative dispute, but the court almost never does that.

Establishment of a procedural guarantees for sanctioning of the violation of the obligation for keeping tax secret by employees of the Public Revenue Office

The Law on Tax Procedure determines a clear duty of the officials to keep all information and data as a tax secret that they found in a tax, misdemeanor or court procedure (Article 9 of the Law on Tax Procedure) On the other hand, the law does not regulate a procedure by which an individual who believes that thy have been violated by failure to this obligation will be able to request responsibility from the official or the Public Revenue Office, neither provides misdemeanor provisions that will sanction this treatment. In 2016, on two occasions, publicly were leaked and published information about the gross and net incomes of employees in Civil Society Organizations, as well as civil activists which in the manner that were presented are part of the annual tax returns of the natural persons or part of the annual reports of the payers of incomes (Civil Society Organizations) that are a tax secret.

Recommendations regarding the authorizations of the law enforcement institutions in criminal procedure

Law on the Financial Police

Harmonization of the Law of the Financial Police with the Criminal Procedure Law with regards to the authorization of the Financial Police to apply use of “hidden data sources”

The Law on Financial Police in Article 13, paragraph 1, point 14 states that while performing the activities within its competence, the Financial Police have authorization to conduct special investigative measures and **“hidden data sources”** in compliance with the Criminal Procedure Law. Although the Law on Financial Police in this provision refers to the Criminal Procedure Law, the **“hidden data sources”** are not stated at all. They are not defined by any law, neither are there any cases when they are used, neither there are procedural rules for their execution. This provision was deleted from the Law on Police with the amendments from Official Gazette of the Republic of Macedonia no.145 from 19.11.2012, but the application of **„hidden data sources”** remains a deterrent in the authorizations of the Law on the Financial Police. That means that not only does this provision from the Law give excessive and vague authorization to the Financial Police, but in the same time it give more authorizations to the Financial Police rather than the Police (MOI) or any other investigative authority. That is why it's concluded that the provision authorizing the Financial Police to use hidden data sources in the Law of Financial Police should be removed.

The Law on Criminal Procedure

Detailed regulation of the Article 287 and clear determination of the cases where the Public Prosecutor can request information, as well as to define the persons and entities from whom can, or from whom these data can't be requested, and to establish judicial protection against the arbitrariness of the Public Prosecutor's work with an opportunity to appeal to a judge in preliminary procedure.

Law on Criminal Procedure in Article 287 Paragraph 1 stipulates that: “Upon request of the Public Prosecutor, the state authorities, the bodies of the local self-government units, organizations, legal entities, and natural persons with public authorizations or other legal entities shall provide the information requested from them”. With this type of authorization, the Public Prosecutor from these entities can: (1) request control over the work of a legal entities and natural persons as well as temporary confiscation until bringing final judgment of money, securities, objects and documents that can serve as evidence, (2) require to perform a tax control and data which may serve as evidence of a crime or property acquired by crime, (3) request inspection controls and notifications for unusual and suspicious monetary transactions. If these entities do not act according to the request, the Public Prosecutor can propose to the court a fine penalty.

Such a vague formulation gives significant disposition to the Public Prosecutor and leaves space for diverse interpretations about in which cases and from whom it can

request such data. Since this provision stipulates that the Public Prosecutor can request data from other legal entities without determination from which individuals and in which situations, neither what type of information, it leaves room for the Public Prosecutor to force a suspected legal entity to cooperate against itself under the threat of a fine penalty of 2500 to 5000 euro, if it does not submit documents that the prosecutor can collect in several other ways stipulated in the Law on Criminal Procedure.

Correspondingly, this article leaves possibility to the Public Prosecutor to circumvent article 194 paragraph 2 from the same Law which stipulates that: “The order for temporary confiscation of objects is issued by the court, at a proposal of the judicial police or the public prosecutor”. This procedural safeguard is also stipulated in Article 20 of the Law on Financial Police. By bypassing this provision, the prosecutor can, under the threat of a fine, to force the legal entity to provide them with all objects and documents, **without having to provide a court order for confiscating the objects which will be used as evidence in criminal proceedings**. The article 287 of the Law is even more problematic, due to the fact that it doesn't predicts any mechanism for protecting the entities from whom the Public Prosecutor request such data, and thus the possibility to abuse these authorizations by the Public Prosecutor remains, who according to the same authorizations it has factual possibility to unlawfully block the operation of legal entities.

With regards to this method of bypassing the procedural safeguards in criminal procedures and forcing individual and entities to provide information the European Court of Human Right has rendered several judgments. In the case *Funke v. France from 1993* and *Saunders v. United Kingdom from 1996*, the Court finds that such a compulsion to the individual or entity to be forced to provide evidence against himself that would incriminate him, is a violation of Article 6 of the European Convention on Human Rights (the right to a fair trial) as well as violation of several procedural rights.

ABOUT THE ACTION:

The action “**Legal Preparedness for Inspections in Civil Society Organizations**” aimed to response to the needs of the CSOs' that were affected by inspections and controls through identification of the needs and the challenges that the those CSOs' were faced by, legal analysis of the inspections, provision of legal support, development of a guide for the CSOs' in case of the inspections. Within the action the following activities were conducted:

1. Organized focus groups with the affected CSOs',
2. Assessment of the current relevant legislative framework,
3. Development of three guides with instructions for CSO in cases of tax control, labor inspections and preliminary and investigative criminal procedures,
4. Providing legal support to the affected organizations and 5. Development of recommendations for improving the legislative framework regulating the inspections and the controls on the CSOs'.

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The action including this document was conducted by a project team composed of:

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