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The role in the integration process of international double taxation agreements – the case of the Republic of Macedonia

Abstract

This article reviews the impact of the tax requirements in one country – the Republic of Macedonia – on EU integration processes. It focuses on international double taxation and its effects at the global level. In addition, it emphasises some specific aspects relating to international bilateral treaties on avoiding double taxation as a means of overcoming the problems of international double taxation in the Republic of Macedonia. The wider context implies the need for an open approach in the Republic of Macedonia, while the article also addresses the introduction of a market-oriented economy and accession to the European Union. Here, the implementation of a flat tax regime in the Republic of Macedonia takes on additional interest since it might be seen to be obstructive to the processes of EU harmonisation and integration. Furthermore, some of the agreements set out limitations on taxation that seem to be in contravention of EU directives in the area of corporate taxation and, therefore, need to be re-thought as the Republic approaches EU membership.

Keywords: *integration, international double taxation, bilateral treaties, Republic of Macedonia*

Introduction

Globalisation, being an irreversible and dynamic integration process, creates a competitive strengthening of the connection between all countries in the world. The quality of the relationship between a government and the commercial sector represents the key to achieving significant success and advantage *vis-à-vis* the global competition in every society.

In the process of internationalisation, the space of nation-states becomes too limited for creating higher value. Open national borders, in contrast, allow for the easy flow of capital, workforce, services and technology, all with the aim of achieving higher value. These processes encompass the mobile workforce, earning profits in a foreign country, the right to pension, etc.

The idea of a single market comes from the European Union and, in its genesis, lies the process of globalisation. This is most evident with companies that aspire to the free flow of capital through merging with foreign companies. Otherwise, if a company tries to enter the international market in a country which is governed by a different regime (or negotiating arena), it may cause changes which can erode the cohesion of that arena. In this respect, the European Union has tried to establish its own regime as a substitute for the weakened national arenas of its member states (Molle, 2001: 33). In fact, this

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'new economy' has a tendency to encourage merger between companies which may be attributed to a new dimension in the generation of different approaches to the so-called 'network economy'. This means that companies now have greater stimuli to merge which, in turn, supports the thesis that a product is much more appealing when it is consumed by a larger number of customers (Shapiro and Varian, 1999).

Basically, when it comes to service markets there has always been a certain closedness. The barriers to free trade in services are an attempt to protect consumers, as well as national companies, from international competition. The European Union has liberalised internal trade in services by increasing cross-border trade and direct investments.

However, the situation with regard to the free movement of labour is completely different. In the past, this has depended on various factors which the European Union has now abolished, thus allowing for the free movement of workers. The principle of the free movement of workers applies both to employees and to freelancers. Nonetheless, we must not forget the perspective of the Union:

> *No-one must be forced to subdue to any social, cultural and legal adjustments after their migration within the EU and, ideally, everyone should be able to find a job in their own country. (Molle, 2001: 33)*

Open labour markets are, above all, a result of the liberalisation of the markets for both capital and goods.

The removal of barriers which obstruct the functioning of the single market requires great effort. Such barriers include, to name a couple among many others, the tax solutions and tax policies of EU member states. In modern terms, there are an increasing number of facts which indicate the occurrence of suitable tax liabilities. Taxes, tax phenomena and tax policy, being important elements in the integration process can, to a great extent, discourage cross-border activity – the basis of all integration processes. For our purposes here, we focus on the phenomenon of international double taxation as a barrier to integration processes.

International double taxation as a barrier to integration processes

The main feature of cross-border activities is the international component which always results in the application of tax legislations in at least two different countries. This subsequently leads the key players in cross-border transactions to a situation of double taxation, i.e. where taxpayers are taxed on the same income, or any other taxable item, by two or more tax authorities of the same rank (Jelčić, 1981: 43).

Where there is double taxation, problems may arise not only between the tax legislations of the states concerned but also between one state and an international organisation (e.g. US citizens who work for the United Nations must pay taxes on their income).

In the past, the introduction and collection of taxes, as the sovereign right of any state, was solely governed by domestic laws even though phenomena such as international double taxation and international tax evasion were already underway. Inacces-

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sible fiscal policies were the main cause of the appearance of double taxation and/or double non-taxation.

It became apparent that open and accessible fiscal legislation and limited autonomy were inevitable in the phase of making tax decisions. Membership of international organisations or of the European Union, and the conclusion of international agreements, can have a substantial impact on rigid fiscal policies by making them more open and flexible. The issue of double or multiple taxation and/or non-taxation can be resolved by:

- unilateral measures
- international agreements (bilateral or multilateral)
- harmonisation of the fiscal legislation, for instance among EU member states.

Here, we focus on international bilateral agreements as a means of overcoming problems with international double taxation as well as on practice in the Republic of Macedonia, a country aspiring to join the European Union and be included in global processes. Ultimately, the movement of economic trends and economic development in south-east Europe are directly determined both by the globalisation process and the transition process.

Double taxation avoidance agreements

Agreements on double taxation avoidance are dominant in the elimination of international double taxation, as is the mechanism for limiting tax evasion in modern economic terms. Nowadays, there are over one thousand double taxation avoidance agreements in effect, of which around one hundred have been concluded between EU member states.

The history of double taxation avoidance agreements goes back to 1872 when the first agreement, on the avoidance of double taxation of inheritance and gifts, was concluded between the United Kingdom and the Swiss canton of Vo. By the beginning of World War I, a total of eleven general agreements had been concluded (Pires, 1989: 95). After World War I, there was a need to typify solutions with the aim of putting an end to international double taxation. In 1963, the OECD Fiscal Committee prepared a Draft Double Taxation Convention on income and capital. In 1977, the OECD Committee on Fiscal Affairs, the successor to the OECD Fiscal Committee, developed a Model Double Taxation Convention on Income and on Capital. This Model Convention addresses the issue of concluding negotiations for bilateral double taxation avoidance agreements and, following the recommendation of the OECD Council, it is used as a guide to concluding bilateral double taxation avoidance agreements.

Due to changes in the world economy, the Committee on Fiscal Affairs amended the 1977 Model Convention regarding the elimination of tax evasion and discrimination in 1992.

The most up-to-date version of the OECD Model Convention was released in 2005.

We must not forget to mention the efforts of the United Nations with regard to the adoption of its Model Double Taxation Avoidance Convention between developed and developing countries in 1980. The difference between these two Conventions is that the OECD Model Convention allows for a broad application of the principle of resi-

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dence, while the UN version allows for a parallel application of the residence principle and the source principle, with an emphasis on the latter.

Modern agreements on international double taxation avoidance are the result of an expressive willingness of two interested parties, i.e. two states, in which one party voluntarily commits to surrender, or partially limit, its exclusive right to taxation in favour of the other contracting party.

The main objective of these agreements is to separate the rights to taxation of the two taxation administrations, but modern agreements also contain additional measures to address possible tax evasion (Arbutina 1998: 14). Where there is no agreement on double taxation avoidance between two countries, taxpayers should abide by domestic legislation which, only in exceptional circumstances, imposes limits on double taxation (Tomulić, 2007: 48).

Such agreements do not in any way constitute a legal basis for the signatory parties to introduce new taxation laws:

> *They are a collection of norms to limit contravening taxation regulations. (Tipke and Lang, 1996: 32)*

The agreements simply determine the circumstances in which income is to be taxed and according to which law, but they do not, in any way, introduce new taxation laws which do not already exist within domestic legislations. In this respect, agreements may not be used as instruments of non-taxation.

Double taxation avoidance agreements constitute *lex specialis* in relation to domestic taxation legislation and, therefore, they have greater legal powers which prevail over those of domestic taxation laws. Domestic taxation legislation and double taxation avoidance agreements are correlated and consequently the agreements should contain the important segments of domestic taxation laws. Apart from this, the agreements also contain points which are unique.

Double taxation avoidance agreements of the Republic of Macedonia

Republic of Macedonia, as an equal legal successor to the Socialist Federal Republic of Yugoslavia together with the other republics, has foreseen in its constitutional law a continuation of Yugoslavia's membership of international organisations and communities. Macedonia has also defined the powers of its authorities in accordance with the existing federal regulations.

This means that, in accordance with Article 5 of the Constitutional Law on the Implementation of the Constitution, Macedonia has adopted as its own all the international agreements and treaties concluded by SFRJ on the date of promulgation of the Constitution of the Republic of Macedonia, and these are now an integral part of our domestic legislation. These agreements shall apply until Macedonia signs bilateral agreements with other countries or renews its existing agreements.

So far, the Republic of Macedonia has concluded a total of 39 agreements on international double taxation avoidance, seven of which were taken over from former Yugoslavia although only six are still in effect (the agreement with Czechoslovakia was replaced by one with Slovakia). Thirty three agreements have been concluded since

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Macedonia gained its independence, 24 of which are with European Union member states.

Macedonia used the OECD Model Convention of 1997 as a model for all its agreements on double taxation of income and on capital. No agreement has yet been concluded by the Republic on the taxation of inheritance and gifts.

The main components of the double taxation avoidance agreements signed by the Republic of Macedonia

The OECD Model Convention recommends an exemption method (Article 23A) and a credit method (Article 23B) for relieving international double taxation. States can choose one method or the other, but it should be noted that the nature of the exemption method is such that it cannot be applied effectively on its own. In this way, the source country retains the right to impose a small tax rate on a certain amount of income, while the country of residence may apply unlimited taxation.

In terms of the taxation of dividends and interest (royalties may also fall under this category unless the signatories decide otherwise), the OECD Model Convention recommends that the subjective tax law be divided between the country of residence and the source country.

Analysis shows that international double taxation is eliminated by deducting taxation at source ('withholding tax') on account of paying taxes in the country of residence.

Methods of the elimination of double taxation on income and on capital are applied in practice in the following combinations: exemption with progression method, to be applied by two states in combination with the credit method on dividends, interest and royalties; a general credit method to be applied by two signatory parties; and a combination of those two in which one state applies the exemption on the basis of the progression method in combination with the credit method on dividends, interest and royalties, while the other state applies the general credit method.

The general credit method is the dominant method of double taxation avoidance in the agreements signed by the Republic of Macedonia, although there are a few cases in which a combination of the exemption with progression method and the credit method is applied.

The credit method is applied to income earned in a foreign country – that is: dividends; interest; royalties; income gained from employment (maritime and air traffic); directors' fees; and the income of artists and athletes. There are profits gained in a foreign country which are exempt from taxation in the country of residence while the country reserves the right to take this income into account when calculating higher tax rates.

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Table 1 – The network of the Republic's international agreements on double taxation avoidance

Gazette Number	Country	Date of entry into force	Date of application
		20. 01. 2008	1. 01. 2008
16/1998	Albania	2. 09. 1998	1. 01. 1999
96/2005	Belarus	26. 01. 2006	1. 01. 2007
23/1999	Bulgaria	24. 09. 1999	1. 01. 2000
48/2000	Denmark	14. 12. 2000	1.01. 2001
7/2000	Egypt	Not in force	/
7/2002	Iran	Not in force	/
157/2008	Ireland	Not in force	/
34/1997	Italy	8. 07. 2000	1. 01. 2001
103/2008	Qatar	26. 09. 2008	1. 01. 2009
49/1997	China	29. 11. 1997	1. 01. 1998
47/2007	Latvia	Not in force	/
103/2008	Lithuania	27. 08. 2008	1. 01. 2009
130/2006	Moldova	28. 12. 2006	1. 01. 2007
47/2007	Great Britain and Northern Ireland	8. 08. 2007	1. 01. 2008
17/1997	Poland	17. 12. 1999	1. 01. 2000
7/2002	Romania	Not in force	/
7/1998	Russia	5. 07. 2000	1. 01. 2001
31/1998	Slovenia	20. 09. 1999	1. 01. 2000
86/2007	Germany	Not in force	/
8/1997	Federal Republic of Yugoslavia	22. 07. 1997	1. 01. 1998
44/1999	Taiwan – China	9. 06. 1999	1. 01. 2000
45/1995	Turkey	28. 11. 1996	1. 01. 1997
21/1998	Ukraine	23. 11. 1998	1. 01. 1999
12/2002	Hungary	14. 03. 2002	1. 01. 2003
7/2002	Finland	22. 03. 2002	1. 01. 2003
23/1999	France	1. 05. 2004	1. 01. 2005

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Gazette Number	Country	Date of entry into force	Date of application
13/1999	Netherlands	21. 04. 1999	1. 01. 2000
17/1995	Croatia	11. 01. 1996	1. 01. 1997
7/2002	Czech	17. 12. 2002	1. 01. 2003
55/2000	Switzerland	27. 12. 2000	1. 01. 2001
21/1998	Sweden	15. 05. 1998	1. 01. 1999
96/2005	Spain	1. 12. 2005	1. 01. 2006
19/2010	Slovakia	Not in force	/
11/1981	Belgium	21.11.1980	1.1.1984
9/1985	Norway	1.9.1983	1.1.1986
2/1986	Cyprus	29.6.1985	1.1.1987
4/1986	Sri Lanka	7.5.1985	1.1.1987
15/1990	Malaysia	24.4.1990	1.1.1991

Source: Ministry of Foreign Affairs of the Republic of Macedonia

Conclusion

Taxes and tax phenomena such as international double taxation on cross-border activities should remain as neutral as possible with regard to achieving higher value. For global economic trends, international double taxation translates into additional expenditure which can obstruct integration processes such that, nowadays, all countries are making a great effort to eliminate double taxation.

For transition countries, bilateral intergovernmental agreements on double taxation avoidance present both an obligation and a need to be more open and prepared to accept the laws of the market economy and, of course, to be willing to be included in integration processes.

The Republic of Macedonia has an extensive network of international double taxation avoidance agreements with many countries in Europe, Asia and Africa. This includes all its neighbours, except Greece, and all the countries in the region as well as China and Russia. It is of great importance to note that there are a great number of agreements that Macedonia has concluded with EU member states. Additional measures for eliminating international double taxation include the collision norms contained within the Law on Personal Income Tax; the Law on Profit Tax; and the Law on Capital Gains Tax. Concerning the level of harmonisation of the tax legislation of the Republic of Macedonia with that of the European Union, as a means of eliminating international taxation, it is clear that the implementation of a flat tax in Macedonia is a deterrent to the process of harmonisation.

This position of the Republic of Macedonia, in the sense of tearing down barriers to international communication, brings forward the issue of sudden openness. To adjust,

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in terms of opening up, means to strengthen one's position in integration processes. The membership of the Republic of Macedonia in the European Union will bring about many changes, some of which will have an impact on existing agreements on double taxation avoidance. In illustration, some of the agreements impose limitations on taxes in the source country regarding the division of dividends which is in contravention of the Directive on common systems of taxation applicable in the case of parent companies and subsidiaries (Council Directive 90/435/EEC).

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