

# Corporate Tax

Second Edition

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# Macedonia

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## Overview of corporate tax work

Taking into consideration the investment-friendly orientation of the Republic of Macedonia (“RM”) as well as its aspirations to become a part of the EU family, tax regulation including corporate tax legislation is the subject of continuous improvement. The main priority of corporate income tax reforms in the Republic of Macedonia is to provide a tax model that will enable a relatively simple and easy administration while at the same time providing a comparatively low corporate tax burden. Also, the other priorities of the Republic of Macedonia are to create a more stable, and much safer investment environment as well as further improvement in the transparency of the tax system.

In this chapter we look at some topics involving corporate tax regulation in the Republic of Macedonia that might be found useful and interesting.

### Transfer-pricing rules

Under these rules, the tax authorities may adjust the taxable income of taxpayers derived from transactions with related companies, if they deem the prices paid or charged to related companies for various types of items to be excessive. In such circumstances, the difference between prices stated in financial statements and “arm’s length” prices is subject to tax. According to the “arm’s length prices” principle, only the transfer prices that are comparable to the competitive domestic and foreign market prices are recognised for the purpose of taxation. Any difference between transfer prices and the competitive market prices must be included within the tax base.

### Thin-capitalisation rules

Under thin-capitalisation rules, interest on loans received from shareholders owning at least 25% of the capital of the borrower, or on loans guaranteed by such shareholders, is subject to tax to the extent that such interest corresponds to the excess of the loan balance over three times the shareholders’ share in the equity of the borrower.

Effective from April 2011, the thin-capitalisation restrictions apply only to loans provided by direct shareholders who are non-residents. In addition, the 25% participation threshold is alternatively measured by reference to voting rights. Loans provided from financial institutions are excluded from the thin-capitalisation restrictions.

### Distribution of dividends

Dividends distributed to either a foreign legal entity, or to resident or non-resident individuals, are the subject of taxation at the moment the distribution is made. Dividends paid to foreign companies are subject to withholding tax at a rate of 10% on the net amount of the distributed dividends (that is, after deduction of the 10% corporate tax), unless tax treaty relief applies.

## Significant deals and highlights illustrating aspects of corporate tax

During the past year there have been some tax issues and questions that may interest foreign companies conducting any kind of business within the territory of the Republic of Macedonia, whether directly or indirectly. They include: withhold taxation; issues regarding permanent establishment of a foreign company; tax consequences regarding cross-border loan agreements; and tax consequences for the mother company regarding salaries of foreign experts sent from the mother company who are employed by a Macedonian company.

Most frequently asked questions relate to withhold taxation, and taxation regarding the permanent establishment of a foreign company.

For example, one of the questions that arose was whether a local licensee is obligated to withhold 10% tax regarding the royalty paid to the foreign channel owner. Namely, pursuant to Article 29-a of the Profit Tax of the Republic of Macedonia, unless otherwise regulated in the international Agreements for Avoidance of Double Taxation, a domestic (Macedonian) company that pays income to a foreign legal entity shall be obliged to withhold tax on payment of the income, and shall pay the tax withheld to a respective suspense account simultaneously with the payment of the income. Pursuant to Article 29-b of the Profit Tax of the Republic of Macedonia, withholding of tax shall apply among others, to income from royalty paid from a resident of the Republic of Macedonia. Therefore, according to the above stated, payment of revenue from the local operator toward the channel owner shall be the subject of withholding tax. In order to avoid double taxation, it is necessary to check whether there is an Agreement for Avoidance of Double Taxation signed between the government of the Republic of Macedonia and the foreign country whose resident is the channel owner.

Another frequently asked question regards the permanent establishment of a foreign company. For example, usually the foreign mother company wants to know whether its expert sent to the local company represents the permanent establishment of a foreign company, and whether the salary paid to the foreign expert is liable for personal income tax and contributions to be paid in the Republic of Macedonia. Namely, according to Article 5 of the Profit Tax Law of RM, a taxpayer is also a permanent establishment of a foreign company for the purposes of profit tax, for the profit it makes from the activities performed in the territory of RM. According to Article 5 of the Profit Tax Law of RM, for the purpose of this law, the permanent establishment of a foreign entity shall be the permanent place of activity through which, or in which, fully or partially, any economic activity of the foreign legal entity is performed in the Republic of Macedonia, directly or through a dependent agent. Among others, rendering services, including consulting services, shall also be deemed as permanent establishment, but only if such activities relate to the execution of one or more connected project, and last longer than 90 days continuously in any 12-month period. While a continuous period of 90 days shall be considered a period of non-interrupted continuance, an interruption of not more than seven days will not be considered as interruption of the continuity. The continuity of 90 days is calculated for the duration of the project, no matter how many persons are included in its execution. Permanent establishment of the foreign company shall be registered as a taxpayer for profit tax at the beginning of the performance of the activity, in order to be given a unique tax number. Therefore, if the foreign expert is an employee of the local company, then there is no permanent establishment, and for the salary paid to the expert for the performed work, personal income tax and contributions should be paid in full in the Republic of Macedonia.

Regarding the cross-border loan agreements, withhold tax is applicable over the interest paid to the foreign company. Namely, according to Macedonian Profit Law, residents who make payments to foreign companies are obligated to withhold tax and to pay it to Macedonian authorities. This refers, among others, to revenues from interest and financial services. The only exemption is if there is an Agreement signed between the countries whose residents are the lender and the borrower. If there is such Agreement signed, then the local company might not be obligated to withhold tax if the foreign company provides a certificate of residential status. This document should be given to the Macedonian company before the payment is made.

### **Key developments affecting tax law and practice**

The tax legislation of the Republic of Macedonia is a subject of continuous improvement and adjustment, depending on the needs of the economy as well as the need of synchronisation with EU legislation. Also, in order to provide better conditions and a friendly environment for foreign investors as well as domestic companies, in recent years new and better solutions have been continuously implemented. Regarding developments in corporate tax legislation, there have been some changes and improvements that should be mentioned.

Namely, between 1994 and 2011 there were several changes made regarding the method of calculation of the base subject of taxation. During the period from 1994 to 2008, the tax basis was calculated as a difference between total revenue and total expenditure, in amounts determined in accordance with accounting regulations and accounting standards (accounting profit/loss or financial results of operations in the business year), which was adjusted (increased/decreased) by the amount of non-deductible expenses and non-taxable income for tax purposes. The calculated tax over the tax base determined in such manner was reduced by the amount of calculated enacted tax exemptions and tax breaks, and the amount of tax paid for the income that the domestic legal person has made abroad, directly or through its subsidiary. Starting from 2006, withholding tax taxation was introduced (withholding tax) which is calculated over the disbursed revenues toward foreign legal entities from the Republic of Macedonia on the basis of dividends, interest, royalties, entertainment or sports activities, performance management, consulting, financial services and research services, real estate leasing, insurance premiums for the insurance or reinsurance of risks, and telecommunication services between the RM and the foreign country, unless otherwise regulated by international treaties for the avoidance of double taxation with the country in which the recipient of the income is a resident. Since 2009, the Republic of Macedonia has applied the so-called “Estonian model” of taxation of profits. Namely, according to this model, only the amount of fiscal basis, i.e. unrecognised expenditures, are taxable, deducted by the amount of tax credits and tax reductions and exemptions. The accounting gains realised for the tax period (year) are subject to taxation only if they are distributed as a payment of dividends and other payments from the proceeds. If profits are accumulated and reinvested to expand the activity, then they are not subject to taxation.

In 2010, a need was identified for a system in which capitally connected companies – residents of the Republic of Macedonia – will be allowed profits that are distributed as dividends between the companies in the chain, not to be taxed multiply. Thus was introduced the “principle of exemption”, which provides taxation of distributed profits in the form of dividends to be paid at the end of a chain, by the last taxpayer that the distribution of profits will benefit, to the shareholders/members-individuals and to non-resident legal entities who are the owners of capital.

Except for the changes regarding the method of calculation of the tax base, in the past few years there has been a tendency towards improved communication between taxpayers and the tax authorities. Namely, several changes have been made in order to provide better and easier communication with the tax authorities and an easier way of submitting tax forms. Starting from January 1, 2013 all monthly VAT taxpayers are obliged to submit the VAT forms in electronic form, and this will be obligatory too for quarterly taxpayers starting from July 1, 2013. Also, the Annual Report for paid-revenues taxpayers can be submitted using the system of E-taxes. In future, the system of E-taxes will be the subject of further improvement.

During 2013 and 2014 further improvements and amendments of the VAT and profit tax were introduced in order to overcome some vagueness in the law provisions and problems in their implementation in practice, as well as to prevent some negative occurrences and abuses of the laws.

Starting from January 31, 2014, the tax base subject to profit tax is expanded. Namely, by the new statutory solution, all outstanding claims arising from transfer of funds which in their economic essence are loans, if not returned within the same year in which the transfer of the loan is made, are subject to taxation. Pursuant to this amendment of the Profit Tax Law, only short-term loans which will be returned by the end of the year in which the loan was approved are tax-exempt. Regarding this amendment, there are two critical points that have to be emphasised; one is that these provisions apply only to loans given after January 31, 2014, but not to loans given before January 31, 2014 as a date when those amendments entered into force, and the second refers to December 31 each year. Namely, all the loans given during the current year that are not returned by December 31 in the current year shall be subject to taxation. Also, this tax obligation applies to both related and unrelated entities. In other words, taxation of the calculated interest between the related entities is criterion that leads to different tax treatment, but when it comes to the taxation of loans, this criterion is not relevant. The amount of tax paid pursuant to this amendment is not a permanently lost asset, because it can be used as tax credit in the following tax period, if the loan is returned. Namely, at the moment when the loan is returned, the tax payer has right of deduction of the tax base for the year when the loan is returned, for the amount of the profit tax previously paid. Starting from January 31, 2014, the former legal solution which was applicable until July 2010, is now re-introduced.

Starting from July 2010, dividends paid to legal entities resident in Macedonia were tax-exempt, but now with the amendments, taxation of the dividends starting from January 31, 2014 is re-introduced. In order to avoid double taxation of the incomes arising from dividends, it is prescribed that the incomes arising from dividends realised with participation in the basic capital of another taxpayer, are not included in the tax base, if the paid dividends have already been taxed at the company which is a payer of the dividends.

Also, amendments of the VAT law were introduced by which some doubts that had been present in the practice have now been resolved. In addition, the list of trades with privileged treatment is temporarily (until Macedonia becomes a member of EU) enlarged. Namely, now the VAT tax base regarding paid provision for the service – ceding of employee – is clearly determined. Also, a preferential tax rate of 5% VAT now applies to trade in computers, thermal solar systems and components and software for automatic data proceeding. For the first time from February 1, 2014, a “reverse charge system” is introduced, but only regarding trade and services, as construction, waste trade and trade of real estate remain within force execution procedure.

Other changes the implementation of which is postponed until July, 2014 are tax exemption of foreign donations, and cassation of annual taxpayers and their conversion to quarterly tax payers.

### **Attractions for holding companies**

One of the priorities of the Macedonian government is to establish an investor-friendly environment with favourable opportunities and conditions for doing business, and to promote the Republic of Macedonia as the “New tax haven in Europe”. For those purposes, the government has established the Agency for Foreign Investments and Export Promotion, as well as the Directorate for Technological Industrial Development Zones (DTIDZ).

There are several Technological Industrial Development Zones (TIDZs) established in the territory of Macedonia: two in Skopje, one in Tetovo, one in Stip and seven others in other cities in Macedonia.

The incentives that the Republic of Macedonia provides for foreign investors in the TIDZs are:

- *10-year tax holiday*

Investors in TIDZs are entitled to 10-year profit tax exemption and to 100% reduction of personal income tax for a period of 10 years. Therefore, the effective rate of personal income tax shall amount to 0%. Also, investors are exempt from payment of value added tax and customs duties for goods, raw materials, equipment and machines.

- The land in the TIDZs in Macedonia is available under long-term lease for a period of up to 99 years at concessionary prices. Investors are exempt from paying utility taxes to the local municipality and fees for land building permits, and receive free connection to natural gas, water and the sewage network. The government of the Republic of Macedonia may assist with construction costs of the user in the TIDZ up to €500,000, depending on the number of new employees and investment amount of the user.

- *Green customs channel for goods*

In contrast with the rates applied outside the zones, TIDZs can be recognised as a real tax haven for the first 10 years after commencing business within the zone. Namely: customs duties applied outside the zones for raw materials are 0-15% and for equipment 5-10%, in comparison with the 0% applied within the zones; the VAT rate applied outside the zones is 18% in comparison with the 0% applied within the zones; and corporate and personal income tax rates applied outside the zone are 10% in comparison with the 0% applied within the zones.

For those entities that are not beneficiaries of TIDZs, the corporate tax rate applied is 10%. The rate of 10% is implemented uniformly in the whole territory of the country. With the implementation of the flat tax rate, Macedonia has become one of the most attractive tax packages in Europe. The flat tax rate introduces a simple tax system that stimulates successful companies to further improve operations and increase profitability.

Withhold tax at the rate of 10% is applied over the payment of revenues made to foreign entities. Revenues that are subject to taxation with withhold tax are: dividend; interest; royalties and revenues from entertainment and sport activities; insurance premiums; telecommunication services; and rent.

In order to avoid double taxation, Macedonia has signed international treaties for the avoidance of double taxation with many countries all over the world, and is enlarging this

list of countries continuously. The Republic of Macedonia has signed agreements for the avoidance of double taxation with 42 countries including the following countries: Albania, Austria, Belarus, Belgium, Bulgaria, Croatia, Denmark, Egypt, Estonia, Great Britain, Hungary, Iran, Ireland, Italy, Latvia, Lithuania, Germany, Finland, France, Hungary, Morocco, Moldova, Netherlands, People's Republic of China, Poland, Romania, Russian Federation, Slovakia, Slovenia, Ukraine, Taiwan-Republic of China, Turkey, Qatar, Belgium, Bosnia & Herzegovina, Azerbaijan, Sweden, Yugoslavia, Spain, Luxemburg, Kuwait, Norway, Kosovo, Kazakhstan, Czech Republic and Switzerland.

### Industry sector focus

Using the benefits that TIDZs provide, many foreign investors have decided to invest in Macedonia, including:

- Johnson Controls automotive plant in TIDZ Skopje 1;
- Johnson Controls investment project for a new 'cut & trim' factory for car seats in TIDZ Stip;
- Van Hool's investment in a production facility in TIDZ Skopje 2;
- Johnson Matthey's plant in TIDZ Skopje 1;
- Johnson Matthey's construction of a second plant located also in TIDZ Skopje 1;
- TeknoHose has registered Vitek Macedonia company and bought an advanced factory in TIDZ Skopje 1;
- in the TIDZ Skopje 1, Kemet Electronics has started construction of new facility;
- Protek Group has registered the Prodis company in Macedonia and started construction of a new manufacturing facility in TIDZ Skopje 1; and
- Samvardhana Motherson Reflectec (SMR) has started two investment projects in TIDZ Skopje 1.

Also, the following foreign investors have invested and built their capacities in the Republic of Macedonia: *KROMBERG & SCHUBERT* (German factory for supply of electrical systems, cables and plastic components), *Drekselmaer* (German factory for cables in auto industry), *Grishko* (Russian factory for ballet shoes), *Cofcab* (Tunisian factory for electric cables in auto industry), and *Van Puijenbroek* (Dutch factory from textile industry). Other investors from USA, China, Holland, Dubai and other countries have declared their interest in investing in different industry sectors in the Republic of Macedonia.

### The year ahead

In November, 2013 the Project "Reforms in Macedonian Tax System" that has been successfully realised during the past 16 years, has been finally completed. This Project was supported by the German Society for International Cooperation (GIZ) GmbH and has been successfully realised in cooperation with the Ministry of Finance of the Republic of Macedonia. At the end of this project, the draft version of the new Law on VAT was submitted to the Macedonian Ministry of Finance. The new regulation is supposed to facilitate the integration of the Republic of Macedonia into the EU and enable Macedonia to fit easily into the tax system of the European Union. The new VAT Law does not prescribe different tax rates and its content is completely in line with European standards. Whether the proposed draft of the new VAT Law will be adopted and whether its implementation shall be realised in phases or not (some provisions to be applied before and some after



the entry of the Republic of Macedonia into the EU), are issues about which the relevant Macedonian authorities will have to decide in the future.

Even though the Project “Reforms in Macedonian Tax System” is finished, it does not mean that the Republic of Macedonia will stop the process of further improvements of its tax system. Namely, as RM is a candidate for EU membership, during the process of its accession to the EU, further synchronisations and improvements of the tax legislation might be required. Pursuant to the Progress Report for RM for 2013 of the European Commission, development of the country in the tax area has been assessed as moderate.

In addition, the programme of the government regarding taxation has been continuously realised in the past period and will continue in future in order to create a stable and safe investment environment and transparent tax system. Namely, according to its programme, the government of the Republic of Macedonia is planning to continue with measures to improve the business climate and increase the competitiveness of the Macedonian economy, by implementing measures whereby the experiences of many European countries, and the recommendations of the World Bank and international financial institutions, are incorporated. Some of the measures regarding taxation that have been implemented or are ongoing are:

- improvement and promotion of E-Taxes – the system for electronic submission of tax returns;
- e-Services for citizens;
- e-VAT (Value Added Tax) – establishment of a system of enumerated invoices that will reduce the need to inspect the authenticity of VAT invoices;
- status change e-Register for tax purposes – the possibility to electronically report status changes to PRO;
- GPRS in fiscalisation – introducing a system for real-time monitoring of cash payments and turnover, which will reduce the field controls;
- mobile tax counters – vehicles equipped for the needs of taxpayers in smaller places where the Public Revenue Office does not have offices;
- IT Forensic Laboratory – in order to counter highly sophisticated forms of tax evasion;
- Regional Tax Academy – training tax administration offices for Southeast European countries;
- e-Auctions – selling seized goods for tax debt collection;
- reminders for payment of individual tax bills in order to speed up collection – sending SMS messages or e-mails about tax liabilities; and
- tax education for newly formed enterprises (continuously).

Also in order to improve the business climate, there are other measures planned for the next couple of years:

- simplified procedures for construction;
- initial price of €1 per m<sup>2</sup> for the sale of undeveloped state land designated for commercial structures, houses, purchase-distribution centres, hotels and other commercial activities;
- reduced cost for privatising land for companies from €1 to €5 per m<sup>2</sup>;
- regular evaluation of fiscal incentives offered to foreign investors in the Technological Industrial Development Zones (TIDZs) for improving and strengthening Macedonia’s competitive position compared to the countries from the region and beyond;
- forming a centralised body for public-private partnerships;

- creating an interactive base of parcels and free industrial facilities that would be offered to interested investors;
- completing the construction of four TIDZs in Skopje (1 and 2), Stip and Tetovo (TIDZ Tetovo with a model of public-private partnership, the procedure for finding an investor who will develop the zone continuously) and if the financial circumstances allow it, an additional seven TIDZs will be constructed in the following four-year period (Kichevo, Prilep, Struga, Gevgelija, Strumica, Radovish and Rankovce);
- forming three Green economic zones where companies that use clean and advanced energy-saving technologies will be accepted;
- support for opening new industrial zones in municipalities will be provided, such as the Zhabeni zone in Bitola and other cities;
- locations for developing logistics parks will be determined, which will support investors in the fulfilment of their activities;
- programmes and studies at technical universities will be stimulated, intended for the needs of the investors, whose production processes require specific knowledge; and
- through the “Open doors for foreign investors” project, new measures for the liberalisation of the procedure for issuing working permits to foreigners will be introduced, so as to aid economic growth and investment, as well as transfer technology and know-how.

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In 2003, Dragan Dameski was admitted to the Macedonian BAR Association, and since 2005 he has been a member of the Management Board of the Association of Mediators of Macedonia. He is also a member of the International Advocates Union (UIA) and the International Bar Association (IBA).

Mr. Dameski has advised businesses entering the Macedonian market for a significant number of foreign financial companies (banks, insurance and leasing companies) well-recognised in the CEE financial market, including several of the most important cross-border financings of real estate projects in Macedonia. He has been leading a lawyer in various bankruptcy proceedings including international bankruptcy.

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Elena Nikodinovska graduated from Iustinianus Primus Faculty of Law in Skopje, Republic of Macedonia. Graduating in June 2009, she holds a Master of Science degree in Business Law and is currently working on a doctor dissertation. As of January 2009, she also holds a bar licence issued by the Macedonian Bar Association. After graduation she was a trainee at the Basic Court in Skopje, in the commerce and bankruptcy department. From 2006 till 2007 she worked at the Public Revenue Office – Large Taxpayers Office, as a younger assistant for external control. In October 2007, Elena joined DDK Attorneys at Law, where she mainly works on cases concerning all kinds of civil disputes, telecommunications, contracts, law on obligations, property, labour law, business law issues, insolvency and competition as well as taxation, particularly personal and corporate income tax, VAT, profit tax, and international taxation-tax rates from international agreements avoiding double taxation and property tax.

Elena speaks English and has a basic knowledge of German.

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