

# ESTABLISHING AN ANNUAL ACCOUNT FOR PERFORMERS OF INDEPENDENT ACTIVITY

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**Abstract** The preparation of the Annual account is mandatory for all economic entities in the Republic of North Macedonia. Depending on the type of categorized economic entity, special forms are prepared prescribed by law, in order to summarize them in the Annual account. Performers of independent activity are economic entities that include an individual person – entrepreneur, sole proprietorship an individual person who is engaged in performing agricultural, craft activity, as well as a person who performs a service or free occupation. Accordingly, at the end of the year, it is necessary to prepare an Annual account which contains the Income and Expenses Balance, the Annual Tax Balance for determining the income tax from performing an independent activity and the Income Structure by activities. The main purpose of the paper is to reflect the legislation of a certain part of companies registered in accordance with the law in The Republic of North Macedonia for external reporting and tax purposes. Hence, as a conclusion, the practical preparation of the three forms, implemented in the Annual Account of a sole proprietorship can be seen.

**Keywords:**

annual  
account,  
economic  
entity,  
sole  
proprietorship,  
income and  
expenses,  
tax  
balance

## **1 Introduction**

In the Republic of North Macedonia there is a standardized way of preparing an Annual Account, depending on the type of categorized economic entity and the required forms in accordance with the prescribed law. The category of Performers of independent activity includes individual person - entrepreneur, sole proprietorship and individual person who is engaged in performing agricultural, craft activity, as well as a person who performs a service or free occupation. According to the Law on Trade Companies, a sole proprietorship is a natural person who, in the form of occupation, performs any of the trade activities defined by this law. A sole proprietor is someone who owns an unincorporated business by himself or herself (Internal Revenue Service, 2021). A sole proprietorship also referred to as a sole trader or a proprietorship, is an unincorporated business that has just one owner who pays personal income tax on profits earned from the business (Twin, 2020). The sole proprietorship is liable for his obligations personally and unlimitedly with all his property. According to the Law on Trade Companies, a sole proprietorship is an individual person who, in the form of occupation, performs any of the trade activities defined by this law (Official Gazette RNM, 2004).

All provisions of the Law on Trade Companies that refer to trade companies also apply to the sole proprietorship, except when there are restrictions in the Law on Trade Companies. Any person who wants to register as a sole proprietorship, is need to register in the trade register at the Central Register of the Republic of North Macedonia. In addition, persons who are subject to bankruptcy proceedings, or persons who intentionally caused bankruptcy cannot be registered as sole proprietorships.

## **2 Regulations and forms required for compiling an annual account for performers of independent activity**

A sole proprietorship can be a small business with a few employees or a large business with thousands of employees. In a small business, one person may handle the accounting duties. A large business might have several employees working in an accounting department. Whether large or small, the preparation of financial statements is an important task (Guerrieri, 2003). There is a wide range of forms according to which the Annual account is prepared by the performers of

independent activity. According to the legislation, there is an appropriate obligation for each entrepreneur in accordance with the prescribed regulations, to comply with them and to keep proper accounting records. This indicates the need for uniformity, comparability and harmonization of financial statements. Hence, for compiling the financial statements of the performers of independent activity it is necessary to use the following laws:

- Law on Trade Companies,
- Law on Personal Income Tax,
- Law on Value Added Tax,
- Law on Tax Procedures,
- Law on Procedures.

In addition to the aforementioned laws, certain rules and regulations are required for the preparation of the Annual account. These are the following: Rulebook on the form, content and the manner of compiling the annual tax balance for the taxpayers performing independent activity, Regulations on the form and content of business books, the manner of their keeping and expression of the financial result of taxpayers performing independent activity, Rulebook on the form, content and manner of filling in the Form for distribution of realizer revenues by activities RIA – Recapitulator, the Decree on the nomenclature of depreciation assets and annual depreciation rates, as well as the manner of calculating the depreciation, i.e. the write-off of the value of the tangible and intangible assets and the General Collective Agreement for the private sector in the field of economy (IFRS Consulting, 2001).

### **3 Manner of compiling an annual account for the performers of independent activity**

#### **3.1 Required forms for compiling an Annual account**

All performers of independent activity are obliged to keep accounting records and to prepare an annual accounting accordingly. The objective of financial statements is to provide information about the financial position, performance and changes in financial positions of an enterprise that is useful to a wide range of users in making economic decisions (International Accounting Standards Board, 2007). The Annual

account is prepared as of 31.12 and is submitted no later than March 15 of each year, referring to the previous year. Annual accounting submits all performers of independent activity, except those who are taxed on a lump sum basis meeting certain conditions prescribed by the law.

The persons which submit an Annual account need to prepare the following forms:

- Income Statement (Statement of revenues and expenditures);
- Annual tax balance for determining the income tax from performing independent activity;
- Revenue structure by activities.

### **3.2 Preparing an Income Statement**

The Income Statement is a report that includes the total revenue and expenditures from the operation of the business entity, as well as the value of working assets and the value of inventory. The preparation of this report is prescribed in the Rulebook on the form and content of the business books, the manner of their keeping and presentation of the financial result of the taxpayers (Official Gazette RNM, 2020). In order to make a better interpretation of the composition of the report within in this paper will be displayed the real data from the operation of the company registered as a sole proprietorship who keep accounting records on the principle of double entry bookkeeping.

Revenue from independent activity – are the revenue realized from economic activity, from providing professional and other intellectual services, as well as the revenues from agricultural activity and from other activities whose permanent goal is to realize revenues. When recording revenue in the Statement of income, it should be taken into account whether the performer of independent activity is a taxpayer or not. This is because for those entities are taxpayers (Public Revenue Office of RNM, 2021) the revenue is entered in gross amount, and then the amount for VAT is expressed in a separate column. The expenditures form independent activity – are cash expenditures expressed in order to earn the revenues. The difference between total revenue and expenditures will give the net income or lose from taxation. Separate data in the Income statement include the value of working capital and the

value of inventories. Practically composing of the Income Statements will be shown below.

The sample performer is registered as a sole proprietorship, performing accounting, bookkeeping and auditing activities and tax advice. Which means that the largest and the only one part of the revenue is realized as revenue from rendered services and they amount to 1.039.728 denars. Regarding the expenditures, the following expenditures are realized: Lease for working premises 55.188 denars and refer to expenditures incurred for leasing the space where the work take place, costs for performed services that have character of material costs (transport and other costs) which they cover the costs for transport services, telecommunications, postal services and they amount to 100.853 denars. The calculating depreciation of the fixed assets available to the business entity also appears as expenditure. In order to be able to calculate this item, it is necessary to follow the Regulation on nomenclature of depreciation assets and annual depreciation rates, as well as the method of calculation depreciation, i.e. write-off of the value of tangible and intangible assets (Official Gazette RNM, 2019). It is necessary to calculate the depreciation in a way where the adjusted value will be compared for the amount calculated with the annual depreciation rates according to nomenclature. This rate can be increased up to 50%. The calculated depreciation is 53.440 denars (total facilities and equipment are 217.450 denars, and the depreciation rate of computer equipment with software, telecommunications equipment, passenger motor vehicles, motor vehicles and connecting devices is 25%. What is characteristic in The Income Statements of the Performers of independent activity is the category Paid gross salaries of employees. Here is entered the gross amount of net salary and salary allowances (in this case because the performer has no employees in this fields no amount will be entered). Performers as owners do not earn salary and therefore that amount can't be recognized as expenditures in the tax balance. However, despite the fact that he does not earn a salary, the performer is obligated to pay contributions in accordance with the law and to record them in the field for paid contributions for compulsory social insurance which amount to 115.151 denars. The rate for salary contributions is 26.80% and includes contributions for pension and social insurance in the amount of 18.8%, contribution for compulsory health insurance 7.5%, and additional health 0.5%. Employers that are Performers of independent activity, do not calculated the employment contribution. When it comes to paid value added tax, this performer is not obligated to pay VAT because he has an income less than

2.000.000 denars. Regardless of that, Performers of independent activity do not include the paid VAT in expenditures, because the incomes and the expenditures that are realized are presented in a net amount, and the amount of VAT is not shown. The paid insurance premiums amount to 22.582 denars and they refer to all paid insurance premiums for non-life insurance, in this case it is property insurance.

The Balance includes as recognized expenditures 69.100 denars from the diaries in the amount of (8% for diaries and business trips in the country), travel costs (for own car 30% of the price per liter of fuel for each kilometer traveled, but not more than 3.500 denars per month), field allowances (accommodation, food, etc.) and other fees determined by the Law and General Collective Agreement for the private sector in the field of economy (Official Gazette RNM, 2014). If other costs are incurred, such as research and development costs, life insurance, etc. they are entered in other expenditures field. From research and development they amount to 36.369 denars.

Depending on the amount of revenue and expenditures, the financial result is calculated, which includes the net income before tax and the loss before tax.

Total revenue 1.039.728

Total expenditures (sum of all previously mentioned expenses) 452.953

Net income before tax 586.775

Net income before tax is the starting point for determining the basis for calculating income tax from independent activity in the Annual Tax Balance.

### **3.3 Annual tax balance for determining the income tax from performing independent activity**

The basis for calculating the income tax from independent activity is the difference between the total revenue and the total expenditures of the taxpayer, increased by the unrecognized expenditures for tax purposes (Official Gazette RNM, 2018) in accordance with accounting regulation, accounting standards and provisions. If there any established reasons according to which the performer of independent activity is not able to keep the business books, then a lump sum payment of income tax is legally allowed, which is not the case with the example in this paper.

The performer of independent activity is obliged in the annual tax balance when determining the base for calculating of the tax income from independent activity, firstly to enter the net income before taxation or the loss before taxation. Which field will be fills depend on the data from previous Statement, i.e. of the financial result obtained in it. The sole proprietorship, made a net profit before taxation 586.775 denars, and this is the starting point in creating of the annual tax balance. What is important in this financial report is that in order to determine the tax base, it is necessary to make several calculations based on the data from the operation of the company. First of all, it starts form determining what unrecognized expenditures for tax purposes are. Those unrecognized expenditures will be added to the net income before taxation, which will increase the amount of net income before taxation and will reduce (if any) the reported loss before taxation.

As expenditures that will not be recognized for tax purposes under the Personal Income Tax Law, will be shown below (Official Gazette RNM, 2018):

- The amount determined as the difference between market price and transfer price of the related parties. This takes into account the prices achieved by comparing the prices on the domestic market and the prices on the comparative foreign market;
- Depreciation above the amount determined by applying the depreciation rates prescribed by the nomenclature of assets, which were previously mentioned;
- The residual present value of fixed assets that are not used, but are fully depreciated;
- A part of depreciation by functional method over 10%. The changes made for the calculation of depreciation by the functional method have been deleted and take effect from 2021;
- Part of the interest on loans taken from creditors with the status of related parties over the amount of valid interest rates of commercial banks;
- Paid premium for life insurance for one calendar year, for employees and for the taxpayer who earns income from independent activity above the prescribed amount determined by the law. The recognized expenditures include the amount of up to 76.638 denars. If an amount is paid higher than

prescribed, than the tax base for the advance payment is the difference between overpaid premium and the amount of the premium.

Unrecognized expenditures = (Tax base for advance payment of tax X 11.1111%)  
+ Tax base for advance payment of tax

- Paid non-life insurance premiums
- Paid contributions in voluntary pension fund for one calendar year, for employees and for taxpayer who earns income from independent activity above the prescribed amount determined by law;
- Organized food and transportation to and from work, and other allowances above the prescribed amounts;
- Paid recourse for the annual leave over the amount prescribed by the General Collective Agreement for the private sector in the field of economy, branch collective agreements and collective agreement;
- Interest on loans for the purchase of a passenger cars;
- Reimbursement for using own car for officially purposes above the amount prescribed by the law (up to 3.500 denars per month);
- Fines, penalties and penalty interest for unpaid or late payment taxes, contributions and other public duties;
- Representation costs (in the amount of 90% are considered as unrecognized expenditures for tax purposes and this is a novelty that will take effect from 2021)
- Costs for using the cars and car maintenance and other means of transport of the taxpayer, costs for using rent-a-car vehicles, in the amount of 50% of the amount;
- Payment on the basis scholarships;
- The compensation for leasing the real estate as well as the amount of the compensation the costs related to leasing of the property of the employee when the compensation are paid by the employer;
- Other adjustment of expenditures (Institute of Accountants and Certified Accountants of RNM, 2020).

As 2020 was a year with a lot of accounting specifics regarding COVID – 19, in the order to other adjustments will include the costs incurred for



laboratory tests. Hence, the laboratory tests paid for COVID – 19 are not taxed in advance with personal income tax, for employees per year per employee in the amount of up to 9.000 denars.

Before determining the basis for calculating the tax, it is necessary to be shown the reduction of the tax base. This reduction can be done on the basis of investing in tangible assets in the amount of 30% of the investments that were made, but not more than 50% of the tax base ( in the practical example it is invested in computer equipment and software in the amount of 96.000 denars).

$$\begin{aligned} \text{Tax base} &= \text{Net income before tax} \\ &+ \text{Unrecognizer expenditures for tax purposes} \\ \text{Tax base} &= 586.775 + 0 \end{aligned}$$

(1)

The basis of calculating the tax is the difference between the tax base and the tax base deductions. What is new in the preparation of the Annual Tax Balance (Public Revenue Office of RNM, 2019) is that the calculation and payment of income tax on independent activity for 2020, 2021 and 2022 year will be done at a rate of 10% regardless of the amount of tax base. In the example the basis for calculation is 490.000 denars (586.775 – 96.000). Because in previous year the performer of independent activity is obligated to pay advance payments of the tax, for the tax period, calculating according to the previous year, the difference between the calculated annual payment tax and the advance payments is calculated and the value of the supplementary tax or overpaid tax is obtained.

### **3.4 Income structure by activities**

During the preparation of the Annual account for the performers of independent activity, two reports were previously mentioned, which are submitted to the Public Revenue Office of the Republic of North Macedonia. For the needs of the Central Register, the Income Statement and the Income Structure by activities are prepared. This financial report is submitted in order to see from which activities the company generates the income. Most often, the performers of independent activity have only one activity. Here, the main activities are accounting and tax consulting and therefore

the total income generated by 1.039.728 denars is recorded at code 69.20 accounting, bookkeeping and auditing; tax advice.

#### **4 Conclusion and discussion**

The main purpose of this paper is to understand the special form of compiling an annual account for performers of independent activity. According to the Macedonian legislation, there are numerous specifics that differentiate them in terms of other types of enterprises. In the Republic of North Macedonia there is a standardized way of preparing an Annual Account, depending on the type of categorized economic entity and the required forms in accordance with the prescribed law.

- According to the Law on Trade Companies, a sole proprietorship is a natural person who, in the form of occupation, performs any of the trade activities defined by this law. A sole proprietor is someone who owns an unincorporated business by himself or herself. A sole proprietorship also referred to as a sole trader or a proprietorship, is an unincorporated business that has just one owner who pays personal income tax on profits earned from the business. The sole proprietorship is liable for his obligations personally and unlimitedly with all his property.
- All performers of independent activity are obliged to keep accounting records and to prepare an annual accounting accordingly.
- Annual accounting submits all performers of independent activity, except those who are taxed on a lump sum basis meeting certain conditions prescribed by the law.
- The persons which submit an Annual account need to prepare the following forms: Income Statement (Statement of revenues and expenditures); Annual tax balance for determining the income tax from performing independent activity; Revenue structure by activities.
- In order to make a better interpretation of the composition of the report within in this paper are displayed the real data from the operation of the company registered as a sole proprietorship who keep accounting records on the principle of double entry bookkeeping.

- The basis for calculating the income tax from independent activity is the difference between the total revenue and the total expenditures of the taxpayer, increased by the unrecognized expenditures for tax purposes, in accordance with accounting regulation, accounting standards and provisions.
- What is new in the preparation of the Annual Tax Balance is that the calculation and payment of income tax on independent activity for 2020, 2021 and 2022 year will be done at a rate of 10% regardless of the amount of tax base.
- All data and rules that are incorporated in this paper are in accordance with the latest changes from February 2021.

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