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FACTORING STUDY
for
MACEDONIA

Prepared by SEED
February 2005



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PREFACE

Southeast Europe Enterprise Development (“SEED”) supports the development of Small and Medium-sized Enterprises (“SMEs”) as well as individuals and institutions that serve the needs of SMEs and will enhance the broader enabling environment in which all of these stakeholders operate.

It is with this mandate that the market assessment for factoring was initiated in an effort to develop new financial alternatives for Macedonian companies.

This assessment involves a comprehensive review of the Macedonian environment to appraise the issues relevant to the potential establishment of future factoring companies and corresponding recommendations. The study has been undertaken using the Terms of Reference as a guideline for activity. Emphasis has been given to Macedonia’s legal, banking, tax and accounting requirements and methods, as well as its pervading economy and business culture, and the demand for factoring.

Factoring is a multifaceted product for companies engaged in domestic or international trade that combines both finance and services. Factoring is the purchase and finance of accounts receivable with the services of accounts receivable administration, collection, buyer credit coverage and the corresponding bad debt coverage in the event of loss due to the buyer’s financial inability to pay. It converts accounts receivable into cash, thereby, facilitating the liquidity needs of a company. While this is a general description of factoring, often times, not all of the services are offered, due to differing conditions in each country. So, it is not unusual to see different types of factoring as country infrastructure conditions vary.

The use of factoring is present in over sixty (60) countries, and factoring supports over US \$750 billion of annual trade. It is a dynamic product which combines financing with commercial services. Some countries have very thorough legal and banking legislation for factoring. Others have none. These strong differences can make the introduction of factoring into a new country confusing, although the flexibility of the product affords the opportunity to create a factoring solution for most every environment.

This assessment is divided into two primary sections – the Executive Overview and the Principal Report. The Executive Overview, which follows, is a synopsis of the entire report, but also includes an action plan. The other section, the Principal Report is concentrated on those subject matters in Macedonia that could have the most influence on the introduction of factoring. An understanding of the economy and business climate, and the accounting, banking, and legal structures is necessary in order to properly determine a course of action for factoring. Decisions must be reached on the introduction of factoring and, the type of factoring to be offered.



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The input for the Principal Report is based on desk-top research and in-country field work with Macedonia's business community, professional leaders, and government officials. The common theme was the investigation, analysis, and substantiation of the potential for the introduction of factoring into Macedonia.

Businesses play a key role in the development of all countries whether they are mature or emerging. The growth of all businesses, and particularly SMEs, is fundamental to economic growth and the creation of jobs. However, businesses face many challenges. One of the most daunting is access to funding. Factoring can play an important role in providing financing for all types and sizes of businesses.



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EXECUTIVE OVERVIEW

Summary

The independence of Macedonia from Yugoslavia since the early 1990's and the economic change over the past twelve years has not been a smooth transition, considering that the country was focused on geo-political issues (the conflicts in the region and the war conflict in the country in 2001). But change often requires persistence and the time to improve the infrastructure for new developments.

For the most part, the country's business, legal and banking frameworks over the past few years have developed a structure for factoring. Factoring is known in Macedonia but has not yet been implemented. The Macedonian Banking Law allows factoring as a banking activity, although factoring is not defined. The factoring assessment was initiated by SEED to determine if any market modifications would need to be made before implementing factoring. In addition, a market evaluation of fifty Macedonian businesses (primarily SMEs) was completed.

A need for factoring exists in Macedonia. The economy had a small, but positive growth in 2003. If the delicate political setting remains stable, there is hope and expectation for continued expansion. A number of private banks are interested in implementing factoring. Future development of factoring is supported by the NBRM. SMEs are in need of critical working capital and liquidity. Lending practices in Macedonia have historically been based on real estate which is a common scenario in the early stages of an emerging economy. The continued reliance on real estate, however, creates liquidity void for SMEs that often do not have real estate for collateral. It is vital for growing businesses to have access to financial resources for future success. The recent and successful introduction of leasing has paved the way for additional financial programs to be introduced.

A crucial element in the introduction of a new product is the anticipated demand. An initial assessment of factoring interest was achieved through the SEED survey of fifty companies. Most of the companies expressed interest in learning more about factoring, and thirty-five would like to use it. Even though awareness about factoring is extremely low, the survey shows a high degree of interest in factoring. The survey included companies with domestic and international business.



Predicting demand for a new product is difficult even with positive survey responses. Pricing, an important consideration, has not yet been established. A lack of available information regarding factoring makes comparisons difficult. Even so, a reasonable demand estimate for most countries like Macedonia is between one and four percent of GDP. Based on a GDP estimate of US \$10 billion for Macedonia, a conservative annual factoring turnover could be between US \$150 – 200 million. The table below includes a number of countries in close proximity to Macedonia where factoring is present. In some cases, such as Cyprus, factoring has many years of market presence. Romania, however, has only a few years of actual experience.

Country	Number of Factoring Companies	Annual Factoring Country Turnover (US \$'s millions)
Estonia, Latvia, & Lithuania	15	2,300
Slovenia	4	170
Romania	6	225
Cyprus	3	2,035
Slovakia	6	380
Hungary	17	1,100

Source: Factors Chain International. 2003 Factoring Statistics.

Cyprus has a substantial factoring market which has grown dramatically. A large percentage of the business is domestic and many large and small companies use factoring. Factoring is important in Cyprus for the financing, but it is also used by companies as an efficient means of outsourcing the services of accounts receivable administration, credit investigation, and collection. Factors are experts with accounts receivable. They have to be, because the financing offered is based on repayment of the accounts that are factored.



Macedonia biggest export trading partners are Germany and Italy. Both of these countries have well established factoring companies with very large factoring turnovers. In the SEED survey, neighboring countries were important export destinations. With the exception of Greece, many of these trading partners are at a stage of development more or less similar to Macedonia and have no current factoring activity. There is some potential for export factoring in Macedonia, but the dominant market initially would be domestic factoring. Domestic factoring, using the financial strength of a strong buyer, such as a chain of stores or gas stations, would offset the possible weaknesses of smaller and potentially less credit-worthy sellers. This is termed reverse-factoring and has excellent potential in Macedonia. The seller receives financing and the buyer receives longer credit terms in reverse factoring. By working with a financially strong buyer the factor's risk is mitigated.

The introduction of factoring into most all countries has taken time and often been met with challenges. The business culture will need to change. Bankers will need to take a fresh look at accepting accounts receivable as collateral. These changes, and others, do not seem to be a barrier, however. The attitudes regarding factoring as a new product among bankers, government officials, and the business community are very positive and constructive. In Macedonia, there is a need and a willingness to move forward.

Recommendation

Macedonian SMEs need working capital and liquidity, and factoring should be a future financial product available to Macedonian businesses. The introduction of factoring in Macedonia has very a high probability of success with proper market awareness and education. The initial market size for factoring will initially limit the number of factoring companies to probably two or three private banks not including the Macedonian Bank for Development and Promotion. Awareness and education of factoring are essential to the proper development of factoring in Macedonia. Already, forms of factoring-type activity have been carried out by the banks. A few of the banks have offered single "factoring" transactions which have been successful. Typically, factoring is much more whole-turnover oriented than single transactions. It is normal for a factoring agreement to be for a year and include all (or most all) of the domestic or international accounts receivable sold on credit terms. There are many forms of factoring, single invoice included, and while innovation is fine, the challenge is to send a common message to the marketplace regarding factoring. It would be best to have education and awareness precede further market developments.

It is essential to have clarification of VAT as it relates to factoring. The expectation is that factoring would be recognized as a financial product and excluded from VAT; however, this would need to be confirmed with the proper authorities.



It would be preferable, but not necessary, that the Macedonian laws which reference factoring, particularly the Banking Law, would define the activity of factoring.

The UNIDROIT Convention on factoring should be ratified and signed by Macedonia.

The fact that some portions of the laws of Macedonia recognize factoring is very positive.

Macedonia is very well positioned to move ahead with factoring. There are almost no changes that need to take place, but rather modifications or clarifications are required. Awareness will come with education to some extent. The NBRM expressed interest in being included in future training and education seminars which is constructive to the development of a proper infrastructure for factoring.

Action Plan

An action plan structure for Macedonia would include the following steps and initiatives after agreement has been reached on the results of this assessment:

Round Table discussions (completed)

Banks

Businesses

Analyses of round table discussions (completed)

Input from stakeholders

Clarification on VAT

Factoring Defined

Training/Education

Ratification and signing of UNIDROIT

A formal action plan would involve significantly more specific initiatives, steps, and time-frames, but once completed a campaign for awareness and education could properly position the product for introduction as a financial product. It would, of course, be a commercial decision by banks and non-financial institutions to offer the product. Initial indications are that some of the larger Macedonian banks are interested in offering factoring to their clients.



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THE PRINCIPAL REPORT

Economy*

Macedonia's independence since 1991 has not been easy. Disputes over the country's name and a trade blockade, ethnic tensions, and political turmoil have negatively influenced the country's economic development. After the Greek embargo was lifted in 1996, a four year period of growth followed leading up to the ethnic Albanian insurgency in 2001. Growth in that year was a negative 4.5% due to investor uncertainty, decreased trade, and necessary expenditures on security. The GDP in 2002 was nearly flat, but showed a moderately positive increase of 2.8% in 2003. With the exception of the continued political unrest, the most serious problem is that thirty-seven percent of the workforce is unemployed (1).

GDP is estimated to be US \$11 billion in 2004 and per capita income US \$5,400. The services sector is 58% of GDP, with industry contributing 31% and agriculture the remaining 11%. Industrial production was a negative 5% in 2002. Inflation has remained low at 1.1% in 2002 (1). Electricity is reliable and the road network is in reasonable order particularly given Macedonia's preoccupation with past geo-political disruptions.

*The data provided in this section are provided by Ron Kissling, CIA World Fact Yearbook of 2003.

Business Climate

The environment for commerce in Macedonia is improving, but businesses face the typical problems for an emerging market economy. The legal system is unreliable, and banks lend primarily based on real estate; therefore, liquidity for SMEs is insufficient. The business climate is more advanced than in some of the surrounding countries which is favorable and already has a legal and banking system that recognizes factoring. The successful introduction of leasing is hopefully a sign for the positive beginning of future new financial products such as factoring.



Macedonian law separates businesses into four categories by, among other variables, turnover. They are divided into micro, small, medium, and large companies. Companies with less than Euro 50,000 in turnover are considered micro. Small companies have up to Euro 2,000,000, medium have up to Euro 10,000,000, and large companies are those with annual turnover greater than Euro 10,000,000. Companies in all categories use the invoice as a payment obligation. The bill of exchange is also used, but demand notes are not. The primary forms of communication are the phone, fax and courier. The internet does not have sufficient penetration to be widely used for communication, even though the telephone network is reliable. The mail system is efficient and regular mail is usually delivered within two days in the country.

There is limited credit information on businesses. The Central Register (“CR”), a state owned agency, has available information but the data is from the financial reports that companies submit to the Public Revenue Office. As the companies predominantly generate these reports for tax purposes, the information has limited usefulness. There is one branch of an international credit reporting agency that uses the CR as the main source for trade insurance information regarding Macedonian importers.

Banks do not share their information, but are obligated to submit quarterly reports about their credit portfolio to the National Bank of the Republic of Macedonia (“NBRM”) in a digital format. Therefore, the banks are connected to a system for checking the outstanding loans a company might have with all of the domestic banks. The system gives only the number and amount of outstanding loans, but does not show the name of the lending institution. The Macedonian Bank for Development and Promotion (“MBDP”) offers a new export credit insurance product, but coverage is limited to a very few countries in the world. The information available from the CR and the MBRM, and the introduction by the MBDP of credit insurance is a very good beginning.

It is typical for companies to settle their obligations via wire transfer rather than check. There are two efficient bank payment systems. One operates on a real-time settlement and the other settles accounts at the end of the day. The companies have to give a payment order to the banks and stipulate which system to use. Some of the banks have started to offer payment operations online. There is no use of company checks in Macedonia. Bills of exchange are seldom used for settlement, although there is a legal framework in place. There are no commercial collection companies in Macedonia. Companies attempt to use the court system to collect their problematic accounts.



The business climate is favorable for new financial products in Macedonia. The culture is open to new financial concepts and the legal and banking systems are supportive as well. In addition, comments from the Ministry of Finance and NBRM were most encouraging for factoring. Demand for factoring was estimated through a survey of fifty SMEs and large companies in Macedonia. All of the companies but one had domestic sales, and all but twelve had export sales. Most all of the companies' selling terms are on open account terms of between 15-30 days. First sales are normally on an advance payment basis. An increasing number of companies are learning and trying to manage their credit risks. Bank guarantees and real estate as collateral are sometimes used to support purchases.

The European Union ("EU") and the former Yugoslavian republics are the primary destinations for exporters in the survey. Most of the companies use a combination of payment terms from letters of credit and advance payments to extending open account terms of thirty days. The companies surveyed currently finance their receivables internally and externally through bank loans as can be seen below.

Loans usage	Number of companies
No loans	9
Only short term loans	15
Only long term loans	6
Short and long term loans	20
Total	50

Source: Survey by SEED. May, 2004.

Most of the companies pledged real estate as collateral for their loans, and in some cases equipment as well. Only one company had used accounts receivable as collateral (see table below).

Collateral	Number of companies
Real estate	28
Equipment	4
Real estate and equipment	8
Accounts Receivables	1
Total	41

Very importantly, forty-two of the surveyed companies were interested to learn more about factoring and thirty-five would like to use it. Future activity relating to factoring will need to center on awareness and education.



Taxes

Taxes are always an important business climate ingredient when determining the feasibility for factoring. The taxes in Macedonia can be divided into three categories:

- 1) Taxes on goods, services and properties (VAT, excise duties and property tax;
- 2) Personal taxes and contributions (personal tax, pension, and social contributions; and,
- 3) Corporate taxes (corporate profit tax).

The first group consists of Law for VAT, Excise Duty Law, and Law for the Transfer of Properties. The VAT is generally imposed on all goods and services. The prescribed rates are: general rate at 18% and the preferential rate at 5%. Excise duties and property tax are tax categories with no impact on factoring. Likewise, the personal property tax would not apply to factoring. The Profit Law Tax regulating the corporate taxation is 15 % of the profit tax base, and is one of the lowest in the world. The only tax with potential implication for factoring, other than the normal corporate tax on factoring companies, is VAT.

The tax laws do not identify factoring in any specific way. Trade of goods and services is subject to VAT. Receivables are not goods or services, and therefore, are not subject to VAT. However, if the factoring company invoices for a factoring commission (fees for administration, collection), this might be considered a service which would be subject to the 18% VAT. Factoring, however, is almost always referred to as a financial and not a commercial transaction. According to VAT Law, most of the bank and financial services are tax exempt. Factoring is almost always exempt from VAT as a financial service. One article of the VAT Law does make a firm determination of the applicability of VAT to factoring confusing, unfortunately. Article 23 p. 5d of the VAT Law, states that collection of third party receivables is not tax exempt. It would be preferable to clear up any confusion relating to the VAT issue.

* Note: More on Tax Issues in Annex 2.

Accounting

Currently there is no definition of the factoring activities in the laws in Republic of Macedonia that mention factoring. A factoring company could be established in accordance with the Law for Trading Companies and there are no special capital requirements for this kind of company. This company will have to be careful with its practices from an accounting and tax perspective. This section details the accounting and the tax framework for factoring in Macedonia.



Effective as of 8 May 2004 the Trade Company Law (“Official Gazette of RM” No. 28/2004) prescribes the accounting requirements in the Republic of Macedonia. The new Law does not implement any significant changes in the accounting regulations as compared with the previous Trade Company Law (enacted in 1996 and amended several times, latest amendments made in 2003). It is important to note that before 2001, the Law on Accounting regulated the accounting issues. The accounting practice in Macedonia is generally based on this Law.

The companies are obliged to use a chart of accounts that is a standard grouping in accordance with Bylaw. The prescribed chart of accounts does not obscure usage of IAS. Statutory financial reports, prescribed by law, consist of the balance sheet, income statement, annex (supplementary statement for all companies) and tax statement. These reports do not include relevant notes that may help readers to better understand the business of a company. Rather, they are more oriented for tax and national statistical purposes.

The Trade Company Law adopts International Accounting Standards (IAS) as national standards. All companies are divided into four groups by their size and this classification is crucial for determining the implications implementing the IAS. According to the trade Company Law, International Accounting Standards are obligatory for:

1. Banks and financial institutions (also prescribed by the Bank Law)
2. Insurance Companies (also prescribed by the Law on insurance)
3. All listed companies on the Macedonian Stock Exchange
4. Medium and large companies
5. All companies that are subject of consolidation of a/m companies.

The other companies that are not mentioned above are not obliged to prepare their financial statements according to International Accounting Standards.

There are no differences on the underlying accounting principles such as going concern, consistency, prudence, matching revenues and expenses, accrual basis of accounting and etc. between the Macedonian Accounting Practice (Macedonian GAAP - Generally Accepted Accounting Principles) and International Accounting Standards. However, there are still departures from International Accounting Standards on specific accounting treatments like accounting for securities, leasing, deferred taxation, and impairment of assets. Whenever the new Trade Company Law imposes the IAS for most of the relevant companies in the country, their practical implementation will take more time due to several reasons:

- 1) statutory financial statements do not include relevant notes that may help readers understand better the business of a company, they are mainly tailored for national statistical purposes; and,



- 2) the knowledge of local accountants for International Accounting Standards is still very poor so several years of intensive training is needed in order to produce accountants able to prepare Financial Statements according to IAS.

None of the laws specifically prescribe the accounting treatment applicable for factoring, because such transactions are not widely spread in Macedonia. The accounting treatment that can be applied is the one that is usually applied for the assignment of receivables. However, there is a big difference between the assignment of receivables and factoring because the assignment of receivables is always contracted with the nominal value of receivables (never on discount). Therefore, the accounting treatment for factoring according to International Accounting Standards is applicable in Macedonia.

The main International Accounting Standard with regard to the accounting treatment of factoring is IAS 39 “Financial Instruments: Recognition and Measurement”, because this IAS deal with financial instruments and the account receivables are defined as financial instruments i.e. financial assets (IAS 39.8).

According to IAS 39, the accounting treatment of financial assets depends upon their application. According to IAS 39.10 there are four categories of financial assets. Their sequential measurement is prescribed in the paragraphs 68-120 and basically the fair value is used as basic criteria for subsequent measurement. The most general picture of the accounting treatment of each one of the categories of financial assets (including receivables) could be described through the following table:

	Category	Initial measurement	Subsequent measurement	Gains/Losses Recognition
1.	Borrowings and receivables that arise from the client	PV (IAS 39.66)	PV, DPV (IAS 39.73)	IS (IAS 39.10)
2.	Investments which are kept until they are due	PV (IAS 39.66)	PV, DPV (IAS 39.73)	IS (IAS 39.10)
3.	Financial assets available for sales	PV (IAS 39.66)	FV (IAS 39.69)	IS or BS (IAS 39.103b)
4.	Financial assets kept for trade	PV (IAS 39.66)	FV (IAS 39.69)	IS (IAS 39.103a)

PV – Purchased Value (Cost)

DPV – Depreciated Purchased Value (Depreciated Cost)

FV – Fair (objective) Value



IS – Income Statement

BS – Balance Sheet

From the viewpoint of a new creditor (transferee), the receivables that are bought under factor agreement should be classified in 2nd category i.e. investments which are kept until their maturity.

According to above schedule, the initial measurement of the bought receivable should be their purchased value (i.e. cost for the receivables - fair value of whatever was paid plus transaction costs). Subsequent to initial recognition, these financial assets are re-measured at amortized cost, less reduction for impairment or the amount that could not be collected.

The factor (transferee) needs to demonstrate intent to hold those receivables to maturity. If it intends to sell the receivables, then they are reclassified to the 4th category, whereby the subsequent measurement is at fair value.

Taking in consideration that most of the receivables in Macedonia are short-term and that there is not marketable place where the fair value of receivables could be measured, the most often case in accounting of receivables in Macedonia is presented in case that follows.

Case Study – Accounting Treatment of Factoring

Company A (old creditor) has receivable of 1 million denars and it sales it to the factor company B (new creditor) at 10% discount without recourse. The accounting entries are as follows:

a) Transfer of receivables at the old creditor (transferor):

Description	Debit	Credit
Cash and cash equivalents (For payment from factor)	900.000	
Loss on transfer of receivables (for 10% charges)	100.000	
Trade receivables (for the amount of assigned receivable at invoiced value)		1.000.000



b) Transfer of receivables at the new creditor (transferee, factor)

Description	Debit	Credit
Other short-term receivables (for transferred receivables at agreed value)	900.000	
Cash and cash equivalents (for payment to old Creditor)		900.000

c) Collection of receivables at the new creditor (transferee, factor)

Description	Debit	Credit
Cash and cash equivalents (for collection from the Debtor)	1.000.000	
Other short-term receivables (for collection from the debtor)		900.000
Revenues (collection from the debtor – difference between the cost and collected amount)		100.000

If the factor adopts the above described approach as an accounting treatment of factoring, than it should also enter an off balance sheet evidence for the nominal value of the purchased receivables.

In the meantime, if the factor realizes that the value of receivables is impaired (i.e. some problems with the collection of the receivables appear), than he will decrease the amount of receivables for probable amount that could not be collected (write-off of receivables) and recognize a loss for this amount.



Banking

The Banking Law was passed in 1993 just following Macedonia's independence. The banks already established at that time went through a process of privatization and reorganization. While in the period of 1993-1994, a number of new banks were established. Banks in Macedonia are allowed by the Banking Law (delivered year 2000) to have factoring. Presently, only a very few invoices have been "factored" and, then, only on a transactional basis. Factoring is generally performed based on a process or flow of all of the accounts receivable, not single invoices.

Today, there are 20 banks (more on Macedonian Banks in Annex 3), one branch of a foreign bank, and 17 saving houses operating in the Republic of Macedonia (in January 2003 a receivership procedure was initiated against Export Import Banka AD Skopje and, therefore, this bank is excluded). Out of 21 banks, 17 are licensed for performing financial activities specified in Article 45 and Article 46 of the Banking Law (fully-fledged banks eligible for performing forex operations on the foreign exchange market). They have a minimum of EURO 9 million paid-in capital. Three of these banks are licensed to perform the financial activities provided for in Article 45 of the Banking Law. Only one bank is established as a micro credit bank under a special Law. The saving houses compose an insignificant 0.97% of the total assets of the banking system. The banking industry is highly concentrated in two banks which control over 50% of the total banking assets, deposits and market share (3,4). Information regarding the Macedonian banking system is available at www.nbrm.gov.mk.

As of December 2002, 85.9% of the banking capital was privatized, or 90.3% if the MBDP was excluded which is state owned. Foreign capital makes up 44.4% of the total banking capital with ownership ranges from 0.2% to 100%.

The regional structure of the banks is highly asymmetric with 88.8% of the total banking potential being located in Skopje, the capital of Macedonia. Only 4 banks are located outside Skopje. This is, however, alleviated by the extended network of branches and windows. At the end of 2002 the banks in Macedonia (not taking into consideration Poshtenska Banka AD Skopje) had 34 branches, 250 windows and 13 business units.

The average bank capitalization ratio at the end of 2002, as a relationship between the banks' own funds and the banks' assets, equaled 20.7%. As of the same date, the banks' total assets amounted to EUR 1,515 billion.

In spite of the permanent downward trend in the capitalization ratio over the years, it is still fairly high, which is due to the following:

- Insufficient mobilization of the available funds;



- Limitation of bank's activities by the National Bank of the Republic of Macedonia (NBRM); and,
- Capital requirements.

Macedonian banks are engaged in international transactions (p/o; L/C; L/G), in domestic payment operations, and in short-term and long-term lending to businesses and households. Revenues from these lending operations are the primary sources of income for banks.

As of December 31, 2002, the average capital adequacy ratio for the Macedonian banks, calculated on the basis of the guarantee capital and categories of risk assets, amounted to 28.1%, showing a high level of risk assets within the balance sheet and off balance sheet. The non-performing loans in the credit portfolio amounted to 12.5%. The total amount of claims, excluding balance sheet items classified in risk categories C, D and E (categorization from A to E) represented 27.4% of the total credit exposure.

The Macedonian banks aggregate income statement at YE 2002 indicated a positive net income. Five banks showed losses in their income statements. ROA for the same period was 0.4% and ROE was 2.06%. Macedonia's banking system, while still liquid and with adequate capital, is burdened with an above average amount of non-performing loans and generating less than acceptable returns.

A number of banks have expressed an interest in pursuing and developing factoring, including the MBDP. Factoring gives banks very good administrative control and governance over the accounts receivable due to the procedures and "hands-on" approach to monitoring the collateral.

Factoring usually returns 2-4% on an ROA basis and over 20% ROE in many factoring companies. Because the collateral is self-liquidating in a fairly short period of time (less than six months), there are normally no lingering non-performing loans. The biggest concern for factors is fraud, but the banks' traditional underwriting standards and available credit information lessens this concern.

There is a much higher demand than supply of capital in Macedonia. Therefore, businesses have limited bargaining power with regard to financing services. Once firms do borrow, they pledge collateral usually in the form of real estate. Because of the bureaucratic procedures inherited from the former socialistic society and still present, this process is extremely expensive and represents a high switching cost should the firm wish to change lenders. The process of changing these rigid procedures has started.



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There are no switching costs in the foreign exchange markets. Stimulated by the “bank power-exercising attitude”, businesses take advantage of the opportunity to shop around for the best deal. Moreover, banks need foreign currency for the short-term forex market. In a situation when a country experiences a current account deficit, foreign currency is a scarce resource. The banks purchase foreign currency either from the exporters or from the citizens. The exporter in this case tends to choose a bank with which it has the best cooperation. Sometimes banks make special accommodations for the exporters because the strong foreign exchange market position gives a much better prospect for the overall performance of the bank.

Firms are obliged to keep their money in the banks. As depositors, they usually look for the best relationship and are do not switch just for a better interest rate. On the other hand, citizens look for the best rates, but the top priority is safety. Macedonians are group-oriented and they value strong personal relationships. Building strong personal relationships with its customers should be a bank’s key strategy for capturing and retaining customers. This includes providing professional and efficient service and offering new financial resources.

* Note: More on Macedonian Banks in Annex 3.



Legal

This section is a condensed report on the Macedonian legal issues impacting the development of factoring. The complete report prepared by Macedonian legal consultants is available in Annex 1 of this assessment for interested readers and those interested in the unabridged information.

Factoring is provided for in the Banking Law, the Law against Money Laundering, and the Law for Foreign Currency Payments. There are no regulations in the Macedonian Law on Obligations for factoring or the other special law(s), as is the case with leasing, insurance, mortgage and pledges.

The lack of a special law for factoring, however, does not mean that there is no legal framework for factoring. In fact, there is a structure for factoring.

Besides the above mentioned laws, provisions regulating factoring-type activity and operations are stated in The Law on Obligations. So, while factoring is not specifically mentioned in all of the laws, the underlying activities of factoring are supported by Macedonian legal structure.

Banking Law

Factoring is mentioned as a bank activity in article 2 line 21, but is not a defined term. As per article 45 and 46, banks founded with Euro 9 million in capital can engage in the financial activities of factoring. Also, the Postal Bank in article 47 has permission to undertake factoring. The provisions of the Banking Law allow banks and the Postal Bank to factor but only for the account of their clients. And similarly, the Law allows non-bank financial institutions to do factoring.

Law for Foreign Currency Operation

The Law of Foreign Currency Operation (“LFCO”), in article 2, paragraph 22, as Commercial Credits defines credits which are directly related with international trade of goods and services, where one of the involved parties is a resident of Macedonia. Also, Commercial Credits are treated as trade credits, such as a delayed payment. Commercial Credits also list activities involving the purchase of accounts receivable such as factoring, forfeiting, and similar transactions.



NBRM establishes the terms and conditions for residents to make credit deals in foreign currency and perform the payments related to the transactions. The transactions are defined and include the buying of accounts receivable between residents and nonresidents if the buyer is a resident (for example, export factoring). According to LFCO, factoring is treated as a commercial credit in connection with international goods and services trade or as the transaction may deal with accounts receivable buy out. NBRM requires reporting of these types of transactions.

Law against Money Laundering

This Law regulates the measures and actions for the prevention of money laundering and organization and control of their use. According to article 2, measures and actions for detecting and preventing money laundering should be taken by legal and natural persons in activities related with investments, credits, exchange, transfer and other money transactions, as well as conclusion of legal affairs for property acquisition and other forms of money or property disposal that can be used for money laundering.

In article 3 the Law defines the specific expressions used in this Law. A financial institution is a defined legal entity which performs one or more of the following activities related to collecting deposits, credits approval, foreign currency exchange, issuing of credit cards, economic and financial consulting, leasing, factoring, and insurance.

Law on Trade Companies

The Law recognizes four types of companies. They are general partnership, limited partnership, limited liability company, and joint stock company. the most common forms of companies are those with limited liability. Managing the accounting, trade books, and annual accounts is regulated by this Law. The Law is very precise as to the records to be kept and the submission of reports. Factoring companies are allowed to maintain records and/or books for third parties.

Law for Agreed Pledge/Guarantee

The Law for Agreed Pledge/Guarantee organizes the terms, conditions and methods for establishing, existence, realization and ceasing of the agreed pledge right over mobile/movable positions, securities, claims and other pledges, and over real estate (mortgages). The pledge, according to article 2 from this Law, secures the financial and other claims whose value is measurable in currency and that is in possession of



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the creditor and related to the debtor in an obligatory relationship. The pledge can be either governing or non-governing.

The right to a non-governing pledge over securities can be acquired by concluding an agreement for a pledge by making an inventory list and description of the security(s) and by registering the pledge in the pledge register. The right to a governing pledge over security(s) is acquired by concluding an agreement for pledge or transfer of the security(s) into the pledge-creditor possession. The pledge ceases by erasing the pledge from the pledge register/public book. The pledge right ceases by the pledge-creditor at the termination of the full pledge.

This Law through its regulations which includes both real estate and mobile/movable assets creates a high degree of security for creditors and allows for an effective and efficient payment of the requirement/claims secured by the pledge. The Law also allows the pledge-debtors to keep pledged-goods in their possession during further activities. In this way, the pledge-debtors are allowed to generate income and pay their credits.

General Framework of the Obligations Law

The obligations legislation of Macedonia has evolved over the past twelve years. The 1991 Macedonian Constitution laid the foundation for the new social and economic structure. The new laws that should have regulated the legal reform according to the Constitutional law had to be adopted within a year. Eleven years later the Law is still developing which is not unusual. The Obligations Law regulates the relations that arise within the area of trade with goods and currencies. Among other elements, the Law allows for the increase in interest rates if payments are not made in a timely fashion. Factoring is not specifically mentioned in this Law; however, a number of important business principles are dealt with, such as the transfer of debt.

Court System

The authority of the courts in Macedonia is given through the Law for the Courts. Authority from this Law is administered by the primary, appellate and the supreme courts. There are no specialized courts in Macedonia which is one of the reasons that procedures are so lengthy. There is a need to upgrade the Law for Enforcement under the court system. However, the time delays and inefficiency of the court process render ultimate decisions somewhat futile.



International Factoring Sources

Internationally there are two resources that have legal significance for factoring -- the Convention for International Factoring, Ottawa, 1998 UNIDROIT and the draft document for UN Convention for Renouncing Debtor Obligations prepared by the UN Commission for International Trade and the EBRD, December, 2001, New York. Macedonia has not ratified or signed the UNIDROIT accord, which among other things attempts to define factoring for the purposes of global harmonization. The UN draft document does not require ratification.

* Note: More on Factoring Legal Issues in Annex 1.

Conclusion

Macedonia is in need of factoring as a working capital tool for its businesses. The survey of businesses (50 Macedonian businesses were interviewed) supports this conclusion, as well as positive indications of interest from private banks, NBRM, MBDP, and the Ministry of Finance. Banks are allowed to factor and some have performed single "factoring-type" transactions. There are no accounting issues that present difficulties for factoring. Macedonia's tax environment is favorable, with the exception of the possible interpretation regarding the applicability of VAT to factoring as a commercial service, and not more properly as a financial resource.

Portions of Macedonia's legal framework include factoring, although it is undefined. The Bank Law includes factoring as an acceptable financial product for banks and non-bank financial institutions to offer. The Law against Money Laundering and the Law for Foreign Currency Payments also include factoring. While the country's other laws do not mention factoring, there is enough legal structure to support establishment of commercial factoring company in accordance with the Law for Trading Companies and there are no special capital requirements for this kind of company.

Ratification of the Ottawa Convention (UNIDROIT) is recommended .

There is a need in Macedonia for both more awareness and education relating to factoring. The potential market for factoring in the near term is estimated to be US \$150 million with growth over time. It is anticipated that the MBDP and two or three of the banks expressing interest will initiate factoring operations with support from this assessment.



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www.nbrm.gov.mk

Acknowledgements

SEED initiated this market assessment for factoring with no preconceived ideas other than believing that the financial tools available to Macedonian SMEs should be supportive and reflective of their needs. It was believed that the best approach to determine the appropriateness for factoring in Macedonia was to reach out to the varying constituencies for their ideas.

The research was undertaken primarily through interviews with selected businesses, banks, government officials, and the professional community in Skopje. In addition, a survey of fifty businesses was completed. Messrs. Jordan Trajkov and Dragan Dimitrov prepared the business survey, banking, tax and accounting issues, and certain business climate matters. The legal opinions and the report were under the responsibility of Prof. Jadranka Dabovik Anastasovska, PhD. and Valentin Pepeljgovski, PhD., Lawyer. Researched and issued the legal report. Ronald L. Kissling, an international factoring expert with extensive knowledge in emerging markets, was engaged to supervise the review and make recommendations. The time and efforts of many people influenced the assessment. SEED also thanks the representatives of the National Bank of Macedonia, the Ministry of Finance, MBDP, and various private banks for their information, support and time.



ANNEX 1

FACTORING – LEGAL ISSUES

I. Introduction

The Factoring, as a type of commercial service, is based on factoring agreements.

Factoring Agreement is defined as an agreement between the Supplier/Provider (side one) and the Factoring Institution (side two) according to which:

- The Supplier can or will transfer to the Factoring Institution account receivables that result from trade of goods or services between the Supplier and the Purchaser (the owing party), except the ones procured for personal, family or home use;
- The Factoring Institution is obliged to provide the Supplier with at least two of the following:
 1. Finances for the Supplier by means of advance payment;
 2. Book keeping for account receivables;
 3. Payment of account receivables;
 4. Protection from late/delayed payment;
- The debtor needs to be informed about the transfer of account receivables

Factoring in the Republic of Macedonia is mentioned in the Banking Law, the Law against Money Laundering, and the Law for Foreign Currency Payments.

The factoring agreement as a special agreement is not regulated neither by the Law on Obligations of the Republic of Macedonia, nor with other special law(s), as it is the case of for example Leasing, Insurance, Mortgage, Pledge and similar.

II. International Sources

International Sources covering the Factoring are:

- The Convention for International Factoring, Ottawa, 1988 UNIDROIT;
- The Rules of International Factoring Association; and
- The Rules of International Factoring Chain, and



- Draft document for UN Convention for Renouncing Debtor Obligations prepared by UN Commission for International Trade and European Bank for Reconstruction and Development – December 2001 in New York.

Republic of Macedonia didn't ratify or sign the Convention for International Factoring from Ottawa.

The other sources of the international business law are autonomous trade practices, and as such are not subject to ratification, but are obligatory only for the members of the above mentioned associations.

III. National Sources

Renouncing of account receivables is important tool for mobilization of financial resources in economic transactions. Differences and insufficient or inaccurate legal regulations restrict the suppliers, buyers and financiers to fully use the potential of these operations (transactions).

In the Republic of Macedonia there is no special law for Factoring, but that doesn't mean that there is no legal framework for factoring.

The Factoring is parenthetically mentioned in the Banking Law "Official Gazette of the Republic of Macedonia" nr. 63/2000 103/2000; 41/2001; 70/2001; 37/2002; 41/2002, in the Law against Money Laundering "Official Gazette of the Republic of Macedonia" nr. 70/2001; 39/2002, and the Law for Foreign Currencies Operation "Official Gazette of the Republic of Macedonia" nr. 34/2001; 49/2001; 103/2001; 32/2003.

Besides the above mentioned laws, provisions regulating the factoring in accordance to which the factoring (actions/means of the factoring) can be carried out are stated in: The Law on Obligations "Official Gazette of the Republic of Macedonia" nr. 18/2001; 78/2001; 4/2002; 59/2002; the Law on Trade Companies; the Law for the National Bank of Macedonia; the Law for Acquiring Joint Stock Companies; and the Bankruptcy Law.

At the same time, important for successful functioning of the Factoring and the subjects that would practice Factoring in the future are the Law for Enforcement Procedure and the Law for Agreed Pledge (5/2003).

Accounting and financial operations and taxes are regulated by the Law for Trade Companies, the Profit Tax Law, and the law for Value Added Tax.



1. Banking law

In the Banking law, which regulates founding/establishing, work/operations, supervision and closure of banks, the factoring is mentioned in article 2 line 21. The legislator under the term Financial Institution defines the legal entity that is not a Bank, but performs one or more of the following activities: credit approval, currency exchange, money/credit/debit cards issuing, economic and/or financial consulting, financial leasing, factoring, activities related to securities for personal account(s) or for the account of the third party, keeping and managing securities, valuables (precious metals etc.), insurance and services regarding money transfer.

As per article 46, the bank founded with capital of 9 Million EUR or more, besides financial activities mentioned in article 45 and 46 can do factoring for its clients.

According to article 47, the Postal Bank as well can do financial activities of factoring for its clients.

Out of all above stated provisions, we can conclude that according to the Banking law, the banks, including Postal Bank, can do factoring, but only for the account of their clients. At the same time the law allows financial institutions that are not banks to do factoring activities. The legislator does not define factoring itself or which activities are considered under factoring.

2. The Law for Foreign Currency Operation

The Law for Foreign Currency Operation, in the article 2, paragraph 22, as Commercial Credits defines credits which are directly related with international trade of goods and services, where one of the involved parties is resident. Also, as Commercial Credits are treated agreed trade credits, like delayed payment or advance payment, and their financing by a bank. In Commercial Credits are also listed activities involving account receivables buy out, such as factoring, forfeiting, and similar when the first transaction when the account receivable is created has commercial credit characteristics.

This law regulates transactions and transfers between residents and nonresidents and between residents (article 3 and 4).

Credits between residents and nonresidents are regulated in articles 20-22. According to article 20, authorized banks can make credit deals with nonresidents in their name and on their behalf or in their name and for others behalf. Residents which are not authorised banks can make credit deals with nonresidents in their name and on their behalf only. National Bank of Macedonia (NBM) regulates the way of evidencing credit transactions with abroad.



Authorised banks can approve foreign currency credits to the residents. NBM establishes the terms and the way for residents to make credit deals in foreign currency and to do payments related to transactions described in article 21 of this law.

Article 42 of this law regulates the reporting about credit transactions. For reporting about credit deals in this law besides other transactions are considered:

- Transactions where the Subject is purchase or sale, or providing certain services, if payment for the goods or services is not done within one year after the delivery of the goods or services;
- Transactions where the Subject is purchase or sale, or providing certain services, if payment for the goods or services is done in a period that is longer then a year and before the delivery of the goods or services;
- Giving and/or receiving mortgage and other forms of pledge
- Buy out of account receivables from legal relations between residents, if the buyer is nonresident; and
- Transactions between residents and nonresidents of buying account receivables from legal relations between nonresidents, if the buyer is resident.

For reporting purposes, NBM can also consider as credit transactions other deals between residents and nonresidents which according to their economic nature have characteristics of credit transactions.

According to this Law, the legislator treats the factoring as a commercial credit in connection with international goods and services trade or as deals for account receivables buy out.

The legislator has provided for control and reporting of NBM about credit transactions between residents and nonresidents.

3. Law against Money Laundering

This Law regulates the measures and actions for prevention of money laundering, and organization and control of their use.

According to article 2, measures and actions for detecting and preventing the money laundering are taken by legal and natural persons in activities related with investments, credits, exchange, transfer and other money transactions, as well as



conclusion of legal affairs for property acquisition and other forms of money or property disposal that can be used for money laundering.

In article 3 the legislator defines the specific expressions used in this Law, where as financial institution is defined legal entity which performs one or more of the following activities related to collecting deposits, credits approval, foreign currency exchange, issuing of credit cards, economic and financial consulting, leasing, factoring, insurance,

4. Law on Trade Companies

The Law on Trade Companies is recognizing the following types of companies:

- o General Partnership;
- o Limited Partnership;
- o Limited Liability Company;
- o Joint Stock Company.

The most common forms of companies that we are familiar with, are those with limited liability. More rarely we have joint stock companies (though banks and insurance companies belong to this category) being used for greater investments. The limited and general partnerships are the least present in our practice and (thus) rarely founded.

Managing the accounting, trade books and annual accounts are regulated with the Law for Trade Companies (art. 536-A to 565-A). In accordance to this Law (in the further text: LTC) the trader is obliged to manage the accounting, and draft and submit accounting statements correspondingly to the LTC, to the generally accepted accounting principles and practices, and in accordance to the adopted accounting standards, with an aim to present the status of the assets, the capital, the liabilities and the work results in a truthful and honest manner.

Every trader is obliged to keep the trade books following the double accounting system, maintaining clear data about the trade legal actions, situation with the capital, assets, liabilities, revenues and expenditures. The trade books are kept in Macedonian language with Arabic numbers, expressed in Denars. The data should be complete and updated. The Law is regulating the methods of registering the inventory, depreciation, re-valuation, compensation for certain expenditures, trade books for the branch offices, the annual accounts, balance sheet and profit and loss account, disclosure of the data, etc.



According to the art.546-a, the traders can transfer their accounting to the outside certified legal entities and individuals, based on an agreement.

Apropos the aforementioned, factoring institution can maintain records and/or books for the third person(s).

5. Law for Agreed Pledge/Guarantee

The Law for Agreed Pledge organizes the terms, conditions and methods for establishing, existence, realization and ceasing of the agreed pledge right over mobile/movable possessions, securities, claims and other pledges, and over real estates (mortgages). The pledge according to art. 2 from this Law secures the financial and other claims whose value is measurable in currency; that is in possession of the creditor and related to the debtor in the obligatory relationship. The pledge can be governing or non-governing, and the mortgage non-governing.

The subject of the pledge can be movable asset/possession, security, certain property claim or other right, whilst the subject of the mortgage can be the real estate only, or a good that is equal to the real estate. According to art. 9 securities, certain obligatory and other rights as subject to pledge are conditional to the general pledge regulations unless otherwise determined with this or other laws. When a real estate of a trade association or other legal entity is a subject to a pledge it includes also the association's branch offices and other entities (parts), unless otherwise agreed or proscribed with the law. When entire trade association is a subject to a pledge, or entire legal entity, according to art. 12 the pledge is including all real estates, mobile properties and non-material rights.

According to art.13 from the Law, every individual and legal entity can appear as a pledge-debtor if having certain currency debt or a due that can be expressed in currency related to the pledge-creditor and arising from certain obligatory or other type of legal relation, as well as a third party that has no debt of a kind, but has agreed to be responsible for somebody else's debt through creating a pledge over its own assets. Any individual and legal entity can be a pledge-creditor if in possession of currency requirement or requirement whose value can be expressed in currency and is related to the debtor who agrees to place over its debt a pledge that favors the creditor; the same can be done through a third person that has no debt of a kind, and who agrees to have a pledge over his own possession(s).

The right to a non-governing pledge over securities can be acquired by concluding an agreement for a pledge by making an inventory list and description of the security(s) and by registering the pledge in the pledge register. The right to governing pledge over security(s) is acquired by concluding an agreement for pledge and by transfer of the security(s) into the pledge-creditor possession.



According to art.16 the right to non-governing pledge over requirement or other sorts of rights can be obtained by concluding agreement for pledge, and with inventory list and description of the pledge claim or other type of right, and their registration into the pledge register. The right to governing pledge over requirements or other type of right is acquired by concluding agreement for pledge and through deviation or transfer of the requirement or other type of right.

The agreement for pledge is concluded in written, except for the agreement for governing pledge that can be concluded in any form. The pledge agreement that is not concluded in written causes no legal activities.

According to the art. 24, while equalizing the value of the asset subject to a pledge the pledge- creditor has a priority right over the other creditors related to the debtor. When there are more pledges related to the same pledge asset, the priority will be set in accordance to the time when the pledges are concluded. The pledge-creditor has a right to set the claims that are needed to protect its own right to the pledge. The claim that is set by the pledge-creditor for realizing the pledge right over the pledge asset is a subject to the rules for protection of the property rights.

The pledge ceases by erasing the pledge from the pledge register/the public book. The pledge right ceases by the pledge-creditor full pledge termination. The termination is valid if the pledge-creditor has issued written statement notarized by a notary public for erasing the pledge from the pledge register, or the public book. The obligatory right that is restricted by a deadline or terminating condition is ceasing after expiration of the due date (deadline) or by fulfilling of the condition(s). The right to a pledge ceases when the right to claim secured by the pledge is fulfilled or will end when all other/additional requirement (interest rate, expenses etc.) are settled, and when erased from the pledge register or public book.

The pledge right ceases if the legal entity that is a pledge-creditor stops to be so, and has no legal successor. The pledge right stops also when the requirement by the pledge-creditor is realized/fulfilled following the ways that are proscribed by this law.

The Chapter 5 from the Law regulates pledge realization/fulfillment (art. 59-82). If the pledge agreement includes no single commercial method for selling the pledge, nor proscribes authorized subject to conduct the pledge fulfillment, the pledge-creditor in this case has the sole right to select the representative to conduct the fulfillment of the pledge. Such a representative can be sought among notary public, the court, real estate agency, stock market and other legal subject included in the law. According to the practice, pledge completion is most often done by the notary public, and the procedure is quite simple and fast. The notary public is carrying out the pledge completion in accordance to the rules of the Law for Agreed Pledge and the Law for Enforcement Procedures.



Based upon the art.77 from the Law, if security appear as a subject to a pledge, and the pledge-grantor is not returning the debt when it arrives, the pledge-recipient can request sale of the securities through the stock market, unless the securities are such that cannot be traded through the stock market. If as a subject to a pledge we have a claim or other right, and the pledge-grantor did not fulfill the obligation that arrived, the pledge-recipient is obliged to require pledge payment. If the pledge claim is granting the right to an interest rate or other temporary giving, the pledge-recipient is obliged to a payment. When the deadline to pay the pledge claim will come, the pledge-recipient is obliged to pay. When the subject of the pledge claim is currency (money), according to art.27 paragraph 2 from this Law, the pledge-recipient is obliged to deposit the requested sum to the pledge-grantor and to notary public or to the court, and if the pledge-recipient also has a claim in currency, and the due time for payment of the requirement has also arrived, he/she can keep for him/herself an amount that equals to what is owned to him/her, and return the rest to the pledge-grantor.

In the aforementioned Law, the regulations within the obligatory right(s) include both real estate and mobile/movable assets and attaining higher degree of security for the creditors, and especially to the creditors, allowing more effective and efficient payment of the requirement/claims secured by the pledge regardless whether they are movable assets, rights or real estates. On the other hand the Law also allows the pledge-debtors to keep pledged goods in their possession during further activities. This way they are allowed to generate incomes and pay their credits that can be used in a case of factoring as well, and as an efficient way and guarantee that the factoring will allow paying back the required amount.

6. General Framework of the Obligations Law

The new obligations legislation of the Republic of Macedonia is a result of the period of change since the independence and until today. The Macedonian Constitution 1991 laid the foundations for the new social and economic structure: political pluralism, building the civil society, equality, market conditions, free competition and pluralism in the ownership structure. The new systemic laws that should have regulated the legal reform according to the Constitutional law had to be adopted in short term of one year. Ten years latter we can say that the reforms obtained a legal framework and this can be considered as a step towards harmonizing our laws on both regional and global level with the modern legal systems, both in the segments of public law and the private law.



The reform of the overall private law in the Republic of Macedonia was aimed to encircle the privatization, activities that were linked to creation of new civil law especially in the area of regulating the ownership rights; than, certain property-related rights, securing the rights of the creditors (through the pledge, mortgage, fiduciary ownership); changes and amendments in the legal regulations of the obligations relations, implementation of the denationalization in the practice, amendments to the trade legislation (anti-monopoly law, law against unfair competition, consumer law, etc.), improvement of the regulations for protecting the rights over the intellectual property, and adequate changes in the civil procedures – litigation, non-litigation and enforcement procedure.

The entire reform of the private law is reflecting over the area of the obligation relations creating what we call – the new obligation law.

The obligations law regulates the relations that arise within the area of trade with goods and currencies. Those are relations that result in accordance to the will of the parties – contractual obligation relations - contracts, relations that are caused by damages and other obligation relations and make the dynamics of the civil law. As a precondition for the obligation relations is to have parties-subjects to the obligation relation, obligation facts that lead to creation of the obligation relationship, subject of the obligation relation that is composed of certain giving, action, omission, or endurance. The content of the obligation relations is composed of certain rights and obligations for the parties within the obligation relation.

The Law on Obligation Relations of the Republic of Macedonia from 2000 is based on the Federal Law for Obligation Relations (LOR) from 1978.

The LOR is treating the general obligatory right in a multilevel manner, including all its trade variants (and accepting the unity between the civil and trade right). The Law includes also special provisions for large number of agreements (classical and some economy agreements). The factoring as well as the other agreements for autonomous trade practice (such as the leasing, forfeiting, engineering, etc.) is still unregulated. Some other agreements in the area of economy are defined through special laws and belong to the foreign trade, the trade companies property rights, etc. The regulations, both general and concrete are used while preparing the agreements if the parties have specifically listed them or if their application was expected during the time when the agreement was concluded. Since the Obligatory Law defines the agreements in the area of economy, such as the classical agreements, Republic of Macedonia and the other former Yugoslav republics have no special law(s) that would define the trade agreements.



The experience of the other former Yugoslav republics is similar/shared. Republic of Slovenia, Croatia, and Serbia and Montenegro kept majority of the former solutions and the concepts within the Law for Obligatory Relations, introducing some changes and adopting the Law as their “new” republic law. This is the reason why the expression “new” is highlighted since we are talking about the old spine-bone regulations (the old Law) with some modifications and new solutions and contents. When the time came to decide and introduce the Macedonian Law for Obligatory Relations, the proposal was to include changes and amendments to the existent Law, and new contents, and modify certain solutions having in mind the codification of the entire civil law.

The aims of the changes in the Law for Obligatory Relations mainly were related to the following: a) eradication of the recidivism and anachronisms – remnants from the previous system; b) adapting the LOR to the new social-economic conditions; c) to complete regulation of certain relations; and d) to include some regulations from other laws and incorporate them into the LOR due to their nature.

The changes are related to the principle of the monetary communalism and the effects of the currency and index clauses and calculating and income rates.

The principle of the monetary communalism is the beginning principle being accepted by the Macedonian Law for Obligatory Relations and is related to the currency obligatory relations. While dealing with the exceptions to this Law, we need to stress that there are great differences in regards to the solutions anticipated within the Law from 1978 and the one of today. Namely, this (new) Law introduces two innovations. The first is related to the so called “currency clause”. According to this clause the Law allows “regulation according to which the value of the agreed obligation in local currency is expressed in foreign currency or determined in such currency”. Having this case into account the Law stresses that “the obligation is fulfilled by paying in local currency in accordance to the NBM and on the day when it is to be fulfilled”.

The second innovation is related to the “index clause”. Compared to the old solution in the Law that is related to this clause (art. 396 from the LOR), the rule is now allowed (art. 385 from the “new” Macedonian LOR) and not restricted/prohibited.

The Law omits parts of the solutions that were specifically targeting the banks and other financial organizations. The reasoning was that different treatment of these subjects by the Law would mean deviating from the Constitutional principles for equal treatment of the trade and market subjects.



While talking about the interest rates, the innovation is that the art.200 from the LOR now includes only the paragraph 2, so that the art.389 from the “new” Macedonian LOR has only one paragraph that states: “It is allowed to have a regulation in the agreement that will anticipate that the interest rate will increase if the debtor did not pay the interest on time”. The difference from the paragraph 1 in the current art.400 that is erased is that there is no possibility to the banks to charge interest on the interest when the debtor would be delaying the payment and for an greed interest rate which was considered as a right arising from the paragraph 3 from the same article that is now erased as well. This is done having in mind at least two reasons: firstly, to have the banks equalized with the rest of the legal parties that can appear as credit or loan grantors, and secondly because in the case of the debtor being delayed in paying the interest rate, the bank still has the right to require payment of additional interest rate according to the right that is anticipated for such cases and is included within the art. 277 from the LOR (or the “new” LOR, art.266). In this situation, the need for lex specialis principle in the law for the banks as special financial institutions becomes unimportant.

The Factoring Agreement is defined in no part of our legal system as a special type of trade agreement.

The Law for Obligatory Relations is securing quality framework for transferring requirements entitled as “Transfer of the requirements with an agreement – cession in the art.424-433”.

The LOR is formulating the requirements that can be transferred with an Agreement.

The creditor, with an agreement concluded with a third party, can transfer to the third party its claim, excluding the one whose transfer is prohibited by the law, the one that is linked to the person-creditor, or the one that by its nature is opposing any transfer onto the other.

Related to the so called secondary rights, the LOR is saying that:

- o With the claim, the recipient accepts the secondary rights as well, such as the right to primary payment, mortgage, pledge, the right from the agreement with the guarantor, the right to interest, contractual penalty, etc.
- o The one who concedes can transfer the pledge-object to the recipient only if the pledge-grantor agrees to it. In any other case, the pledge-object remains property of the conceiver, to keep it for the account of the recipient.
- o It is assumed that arrived and unpaid interest rates are conceded together with the main claim as well.



LOR is regulating the transfer of the claim and states that the agreement from the debtor is not necessary, but the departee is obliged to notify the debtor on the arranged depart/withdrawal. The transfer to the departee conducted prior to the notification for the depart/withdrawal is valid and is releasing the debtor from the obligation, but only in a circumstance that he/she was unaware of the transfer; otherwise the obligation remains and he/she is obliged to fulfill it.

LOR is regulating the multiple depart/withdrawals as well. If the creditor can concede one and the same claim to several persons – than, the claim belongs to the recipient that was first known to the debtor or the one that was first to call the debtor.

The LOR is regulating the relation between the recipient and the debtor. The recipient has all the rights toward the debtor, as the conceder toward the debtor until the concession. The debtor can stress to the recipient that he/she has all the rights to objections, and the right to those objections that the one who conceded could have, until the moment when he/she was informed about the concession.

The relationship between the one who concedes and the recipient – the one who concedes is obliged to give to the recipient a security or other kind of certificate about the debt if he/she has any, as well as other proves for the claim that is now to be transferred, and the additional, secondary rights. If the one who concedes transferred to the recipient only part of the claim that he/she is obliged to, it should offer authorized transcript, security or any other certificate that proves that the transfer is valid. He/she is also obliged to issue notarized certificate for concession.

Regarding the responsibility for the claim, the LOR is stating that when the concession is concluded with an agreement for compensation the one who concedes is responsible for the claim until the moment when the concession is done.

Regarding the responsibility for the payment the LOR states that the one who concedes is responsible only for the claim he/she conceded from if that was the agreement, and only in the amount of what was received by the recipient, and this is valid for the interest rates as well, the expenses related to the concession and the expenses related to the procedure against the debtor. Greater responsibility for the one who concedes cannot be agreed.



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The LOR is setting also special cases for concession of claims as a concession instead of fulfillment, or for the purpose of fulfilling and conceding for collateral. When the debtor instead to fulfill its obligation is transferring to the creditor its full claim or one part of the claim, by concluding an agreement for concession, the debtor obligation is fading in the amount of the transferred claim. When the debtor will transfer to its creditor only the claim for paying, its obligation is fading again or is decreasing, only when the creditor will pay the transferred claim. In both cases the recipient is obliged to transfer to the one who concedes all that he/she paid if it is above the amount of the claim to the one who concedes. In a case when the concession happens due to the payment, the debtor of the transferred claim can only fulfill its obligation to the one that conceded when he/she was informed about the transfer/concession.

When the concession is done with an aim to secure the claim by the recipient to the one that concedes, the recipient is obliged to take care about the payment of the transferred claim as a good entrepreneur or a good host, after he/she will keep as much as it is needed to fulfill the claim to the one that concedes while keeping the rest.

With the LOR the institutions transfer of debt and transfer of fulfillment are also regulated and can be important for the factoring regulations (art. 434-441)

The transfer of debt is done through an agreement between the debtor and the one who took over the debt, as agreed by the creditor. For the concluded agreement they can inform the creditor and each of them can be in return informed by the creditor about his/hers will to undertake the debt. It is assumed that the creditor has given its agreement if without any hesitations accepted any fulfillment by the one who undertook it, and when he/she did that in his/her own name. The agreeing parties, together and separately can call the creditor within certain time to state whether he/she agrees to undertake the debt, and if the creditor does not respond within the stated time, it will be considered that he/she did not give his/her consent. The agreement for undertaking the debt will be valid as an agreement for undertaking and fulfilling obligations for the time until the creditor is to give its consent or until he/she rejects to give the consent. While transferring an estate over which there is a mortgage, it is agreed between the one who obtains the good and the one who makes the transfer that the first will undertake the debt to the mortgage creditor, and it is considered that the mortgage creditor has given its consent for the agreement for transferring the debt if he did not rejected the written call by the one who concedes in one month time by the time when he received the call. The written call to the creditor has to include information about this circumstance/clause otherwise it will be considered as he/she did not receive the call.



By undertaking the debt, the one that agrees to this step, enters the place of the debtor while freeing the debtor from the obligation. If, at the time when the agreement was concluded the one that undertook the responsibilities/debt was in great debts himself and the creditor was not familiar with this, nor he/she had to know that, the former owner is not released from the obligation and the agreement for transferring the debt is active only as an agreement to approach to the debt. Between the one who undertakes and the creditor the obligation is the same as the one between the former debtor and the creditor.

Regarding the secondary rights the LOR is proscribing that the secondary rights that were once existent and related to the claims are remaining to be valid, but the guarantees and the pledges given by third parties will stop if the guarantors and the pledge-grantors do not agree to be responsible for the new debtor. If something is not agreed, than the one who undertakes the debt/else is not responsible for the unpaid interest rates that arrived until the time of the take over.

Regarding the objections in the LOW art. 438 declared that the one who undertakes can inform the creditor about all the objections that arise from the legal relations between the former debtor and the creditor (where is the source of the debt), as well as about the objections from the one who undertakes the debt regarding the creditor. The one who undertakes the debt cannot stress to the creditor the objections that originate from his legal relation(s) with the former debtor and this relation was the base for the take over.

Taking over the responsibilities is regulated by art. 441. The take over of the fulfillment is done with an agreement between the debtor and the third party that serves as an obligation to the debtor to fulfill the obligation to the creditor. He/she is answering to the debtor if the obligation to the creditor is not timely fulfilled, and he/she will ask for fulfillment on behalf of the one who owns it. He/she is not undertaking the obligation, nor approaching to the debt and the creditor has no rights regarding him.

Subrogation – an interesting institute regulated by the LOR (art. 288-293)

In a case when somebody else's obligation has been fulfilled, anyone who fulfilled it can agree with the creditor before the fulfillment or during the fulfillment, to have the fulfilled an action over him with all or only few secondary rights. The creditor rights can be transferred onto the one who fulfilled the obligation in accordance to the agreement concluded between the debtor and the party and concluded before the fulfillment. In these cases the subrogation of the one that fulfilled in the rights of the creditor comes in the moment of the fulfillment.

When the obligation will be fulfilled by somebody who has legal interest in it, the creditor requirement is transferred onto him with all the other secondary rights in accordance to the law.



In the case of partial fulfillment of the creditor requirement the one who fulfilled undertakes all secondary rights that secure the fulfillment of the claim only if they are not needed for fulfilling the rest of the creditor's claim.

The creditor and the one who fulfils (the place) can agree that the guarantees will be used in accordance to their claims and can also agree that the one who fulfils will have the right to primary payment. The creditor is obliged to give to the fulfiller the means that show or secure the claim. There is an exception when the creditor can give to the fulfiller the pledge from the debtor or from somebody else only if the pledge-grantor agrees to that step, otherwise it remains with the creditor to hold it and keep it on behalf of the fulfiller.

The fulfiller that has the claim transferred onto him can require from the debtor more than he paid to the creditor.

LOR is also stating that when there is an exclusion of the responsibility on behalf of the creditor regarding the existence and payables of the claim, the debtor that received the fulfillment by a third person is not responsible for the existence and payables of the claim during the time of fulfillment. This does not exclude the application of the rule on acquisition without legal grounds.

In LOR the following institutions have certain connection or can be used in managing the factoring: sales and keeping the property rights; loan, assignation, credit agreement and credit agreement based on the pledge on securities.

7. Court Protection and the Authorities of the Courts in Protecting the Requirements of the Creditors

The authorities of the courts in the Republic of Macedonia are regulated with the Law for the Courts (Official Gazette of the RM no.36/95 and 45/95). In accordance to the art. 24 from this Law in the unified judicial system, the court authority is done by the primary, appellate and the supreme courts of the Republic of Macedonia. The primary courts are founded for an area that is proscribed with the art. 28 from this Law. The appellate courts are founded for an area that includes more (primary) courts and they are based in Skopje, Bitola and Stip. The Supreme Court of the R. Macedonia is undertaking the court authority over the whole territory of the R. Macedonia.



The primary courts are authorized to decide within the first degree and on court subjects that belong within this category unless they are otherwise regulated and placed under other courts jurisdiction. The primary courts in accordance to art.30 paragraph 2 from this Law are responsible to decide for out-of-process activities under first degree, for executing and securing the papers/data and in tabulations, unless they are otherwise determined by other organs or institutions. According to art.3 the appellate courts are responsible to decide on the complaints against the primary courts decisions.

There are no specialized courts in the Republic of Macedonia after the independence, and this is one of the reasons why the procedures last so long since there is no court specialization.

In the case of lack of fulfillment of the obligations on behalf of the debtor, the key importance rests in the hands of the official system for paying the demands in accordance to the Law for Litigation and the Law for Enforcement Procedures. According to the aforementioned laws the procedure is slow and long lasting. The laws provide efficient procedure(s) for paying the debt and it is necessary to introduce changes to the laws as to prevent (clauses that) protect and give privileges to the debtors, and provide better fulfillment of the laws that will improve respect towards the courts and fulfillment of the debtor-creditor relations and the rule of law.

In certain (extreme) cases the court can require assistance from the police in performing the court decision. Very few cases of this kind are known in practice when even with police involvement, the decision could not be prosecuted.

The regular procedure for paying the debt that arises from an agreed relationship (agreement) and starts with a law suit where the accused is obliged to pay the amount that is owed, with legally set or agreed interest rate, the court and attorney costs. When the verdict is official and if it is not done based on the free will (the debt is not paid entirely and in the set time frame), the proposal is submitted for executing the verdict in accordance to the Law for Enforcement Procedures.

The Law for Enforcement Procedure (Official Gazette no.53/97, 59/00) is regulating the procedures under which the court is acting and forcefully executing the court decisions related to fulfilling the obligation, and well to secure the claims. The regulations that are part of this Law are related to the forceful execution of the decision that is brought within the procedures for managing and is related to financial obligations. The Court is allowing this step based on the Enforcement or truthful decision unless the Law for Enforcement Procedures (LEP) states otherwise. In accordance to art. 17 paragraph 5 enforcement will be allowed based upon court decision that did not become final and decision taken in an administrative procedure that is not final, if the law prescribes that the appeal does not suspend the enforcement of the decision.



According to the art.15 for the LEP under the term Enforcement procedure we understand court decision and court equalization, Enforcement decision and equalization in managing procedures if they are related to fulfilling currency obligations, Enforcement notary document and other documents that as an Enforcement is written under the law.

Credible legal document is the one that is based upon the art. 21 LEP and includes the invoice, the bill of exchange and the cherub, with protest or return receipt when its is necessary as a base for the claim, or public document, excerpt from public books, legal personal documents or other documents that under special regulations have a meaning of public documents. Under the invoice we also include the estimate of the interest rate. The credible ID can be used for executing the task if it contains the creditor and the debtor, the subject, type, the size and the time for fulfilling the obligation.

Received court suggestion for execution fulfilling all legal conditions is a base for decision and is delivered to the debtor. The debtor has a right to objection or complaint depending on the case and whether the court is using the credible ID or Enforcement documents. The objection or complaint can be inexplicable and with no proves which is common in practice (used terminology: "I object the explication/decision on the grounds and amount..."). After receiving the objection, the court is revoking the decision for execution and the subject will be automatically transferred for further resolution in the civil court procedure – a step that again is taking lots of time and allows slow payment of the debt and protection of the debtor.

It is obvious that the Law for Enforcement Procedure is necessary to be upgraded as to be more efficient for the creditor and especially by introducing the so-called "document-based procedure". It is inevitable to change the Law in a way that it will allow bringing charges on behalf of the debtor and against the "truthful document" only exceptionally, when the debtor will give the court documents that state that the debt for timely paid (written prove for the payment). In other words, if the debtor gives no documents that certify that the payment was completed and in the time-frame that was set by the law (or court decision), execution of the decision will be undertaken and the debtor can initiate a procedure that is contra to the execution. It is simply unacceptable that groundless assumption challenging the debt done by the debtor to block the whole procedure after short procedure and to lead to transferring the case from Enforcement procedure to the complicated civil court procedure.

When the debtor is not fulfilling its obligations in accordance to the agreement that states the claims, the creditor can submit the agreement to the court as a "valid document" and by submitting the documents for court investigation that prove that the debtor finished with the obligations can halt the execution of the court decision.



For the aim – to execute currency payments, the court can order the following activities: sales of movable property, sales of real estate, transfer of the goods from the debtor's accounts to the account of the creditor, assign obligation for delivery of the goods, sales of other rights. The same step can be undertaken with an aim to secure the payment, but instead of sales to introduce court decision for new pledge or mortgage, and to base on that ground the activity.

Payment of the currencies on the account is done through the bank where the debtor has its accounts. Every bank is obliged to execute the court decision through taking the stated amount stated within the Enforcement decision from the debtor's account and transfer the same to the account of the creditor.

IV. Conclusion

The aforementioned analysis of the legislative of the Republic of Macedonia that talks about the Factoring is leading to the following conclusions:

According to the Banking Law, the banks including the Postal Bank can do the factoring but only on the account of their own clients if they have at least 9,000,000 EUR basic capital;

The Banking Law is allowing financial institutions that are not banks to perform the factoring activities. But in the Macedonian legal system it is still undefined what "financial institution" is and what are the terms that should be fulfilled as to be founded. Due to securing equal conditions for factoring activities, we consider it is necessary to equalize the terms for founding financial institution that will have the possibility to perform factoring as the banks do (9,000,000 EUR basic capital). Also, the banks should be allowed to perform factoring not only for their clients;

- o The legislator is not defining the factoring activity and is not defining what are the activities that are considered to belong in this area, although the Law for Currency Activities considers factoring as commercial credit linked with the international trade of goods and services, or as an activity related to redeeming claims. Perhaps it might be better if we consider defining factoring within the current legislative and regulations where there are several activities defined related to the factoring (the Banking Law and the Law for Currency Activities). Especially this is related to defining factoring within the local legal market;
- o The legislator is not defining the Agreements for factoring strictly, and this is not an impediment to conclude such deals. In this moment there is a dilemma in our state whether trade agreements will be regulated within the LOR, the special laws as it is the case with the leasing, or within a commercial code. The authors of this text think that the current concept of the LOR should not be abandoned;



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- o It is necessary to have privileged tax treatment while dealing with the factoring aiming to support the interested investors as well as the potential clients as to participate in the market;
- o To sign and ratify the UNDRUIT Convention for international factoring.



ANNEX 2

TAX ISSUES

The Personal Tax Law regulates the personal tax. The common personal tax is 18%.

The Profit Tax Law regulates the corporate taxation. The profit tax amounts 15% of the profit tax base. The calculation of the profit tax base is not complicated and there are many tax releases based on different reasons (foreign investment, reinvestment of profit, quotation on the Stock Exchange etc). The profit tax rate as of 15% is one of the lowest in the world.

The tax year in Macedonia is the calendar year. The taxpayers are residents and in rare cases nonresidents are included.

Tax laws do not stipulate factoring in any specific way. Currently there are two taxes that may affect factoring in Macedonia: 1) the Value Added Tax and 2) the Profit Tax.

Implication of VAT on Factoring

According to a VAT Law, subject to value added tax is trade of goods and services. Receivables are not goods neither they are services. On that account, generally the factoring is not subject of VAT.

However, if the factor company invoices any factoring commission (i.e. provision or fees) that might be considered as a service, than this commission is subject to 18% VAT. Whenever this is a case, on the end this VAT is a neutral transaction, because the company, seller of receivable, pays the VAT to the factor company and in the same time it deducts it from its monthly VAT tax returns. The factor company pays the tax further to the state. The neutrality of the VAT will be a case only if both companies in a factor deal are VAT registered taxpayers. This is not case with banks, so some problems in VAT consideration might appear if the factor company is a bank.

If we consider a factor deal as a financial transaction (financial service) than according to VAT Law most of the bank and financial services are tax exempt. One article of the VAT Law add confusion in this general conclusion, which says that collection of third party receivables is not tax exempt (article 23 p. 5d of the VAT Law). This paragraph is not so clear because we come again to the basic dilemma if sale of receivables can be considered as a goods or services, which are subject of VAT.

If we consider a factor discount as an interest, than the interest will not be taxable since interest is not taxable by any Law.



Implications of Profit Tax on Factoring

Generally, all revenues that come from the factoring business are taxed with a Profit tax, and all expenses that arise from a factoring deal are recognized as an expense in the Profit Tax Statement.

From the factor's (transferee) viewpoint, the revenues from factoring business, whenever they are defined as a commission, fee, provision, discount or interest, are subject of a profit tax. The difference between cost of receivable and its collected amount will be recognized as an income on the date when the receivable is collected. This income is not tax deducted.

More dilemmas regarding the profit tax arise from the viewpoint of the selling party (transferor). He will get lower amount for his receivables than their nominal value. This difference is immediately recognized as a loss. The Profit Tax Law does not deal with a capital loss of trading with receivables. It only deals with capital losses that arise from sale of securities, equipment and property.

On that account, it is questionable how this loss will be treated from the Tax Authorities. There are three options:

- 1) If they are treated as a receivable write-off, than they are not recognized as a expense in a Profit Tax Statement (article 20-a);
- 2) If they are treated as a interest, than they are recognized as a expense in a Profit Tax Statement (article 17);
- 3) If they are treated as a capital loss, than most probably, they will have a same treatment as capital losses from sale of securities, equipment and property, which are recognized as an expense in a Profit Tax Statement (article 25).

Case Study – Tax implications

In order to explain the tax implications on factoring, we will take two cases and analyze the tax issues.

1. Company A (old creditor) has receivable of 1 million denars and it sales it to factor company B (new creditor) at 10% discount.



Company A immediately recognizes a loss amounting 100.000 denars, which is generally a recognized expense according to the Profit Tax Law. In the moment of purchase, there aren't any tax implications for company B. When it collects the receivable, than it will realize a revenue amounting 100.000 denars (for the difference) and this revenue is taxed with profit tax. In this case there are not VAT implications.

2. Company A (old creditor) has receivable of 1 million denars it sales it to factor company B (new creditor) at 10% discount. Company B invoices a commission fee at 10.000 denars. Both companies are VAT registered.

Company A immediately recognizes a loss amounting 100.000 denars and expense of 10.000 denars. Both are recognized as expenses according to the Profit Tax Law. In the moment of purchase, company B recognizes revenue for the invoiced commission of 10.000 denars. The revenue amounting 100.000 denars is realized after collection of the receivable. This revenue is taxed with profit tax.

In this case only the invoiced commission is subject to 18% VAT. Company B Invoice the commission plus 18% VAT and pays the tax. It does not recognize income for the invoiced VAT. Company A receives the invoice and pays VAT to Company B. Further, in the VAT Statement, it deducts this VAT. In this case there are VAT implications, but on the end the VAT has none effect to both parties.

Case 2 a) The Company B (Factor Company) is not a VAT taxpayer - then it does not calculate VAT on the invoiced commission.

Case 2 b) The Company A (Old creditor - transferor) is not a VAT taxpayer – then it cannot deduct the VAT and it is considered as an expense.

We could estimate that the factoring within the domestic business could and would be used by the suppliers of the big, well-established companies and retail chains. This product will have little credit risk for the banks or the factor companies. We could envision that program based factoring could be developed among those business relations.

For the other business relation the banks or the factor companies would look for additional collateral or ways to mitigate the credit risk.

Similarly the exporters that have strong established buyers will probably use the export factoring. And it could be developed on a program base if these exports are continuous with those partners.



RECOMMENDATION

Lack of clear definition for factoring in Macedonian regulation imposes a need for Ministry of Finance and NBRM to prepare clear definition. Probably a support for the development of policies and procedures for the supervisory bodies would be needed.

In addition support for the development of the product and of the credit policies and procedures for the banks that would like to offer this product would also be needed.

Macedonian accounting and tax practice does not regulate specifically the factoring because such transactions are not widely spread in Macedonia. However, none of the accounting or tax laws is obstacles for setting up factoring in Macedonia.

Regarding the accounting treatment, it is recommended that the IAS should take place in prescribing the accounting treatment (mainly IAS 39). Because the knowledge of local accountants for International Accounting Standards is still very poor intensive training is needed in order to produce accountants able to prepare Financial Statements according to IAS could be essential.

It is recommended that the article 23 p. 5d of the VAT Law, according to which the collection of third party receivables is not tax exempt, should be taken out from the Law because it is not clear for what kind of transactions it refers or to be changed whereby it will clearly state that the sales of receivable is not subject of VAT. Also this article is opposite from the general rule of the VAT Law which is that subjects of VAT are only goods and services.

It is also important to clarify what treatment will the discounts have in trading with receivables. Will they be considered as a discounts, interest, fees, write-off or capital gains/losses? Ones this is defined, the tax issues are solved. On that account the article from the Profit Tax Law that refers to capital losses should be extended, stating that the capital losses from sales of receivables have the same treatment as capital losses of sales of securities.

For implementing these proposals the Ministry of Finance should prepare a Bylaw that will regulate all the accounting and tax issues regarding the factoring, from the viewpoint of both sides, as it was done for the treatment of leasing. In this case, it will be clearly stated what are the tax implications, so there will not be a misinterpretations by the factor, buyer, seller, neither by the Tax Authorities.



ANNEX 3 REVIEW OF MACEDONIAN BANKS

Macedonian Banks

nr.	Large banks	Medium banks	Small banks
1	Stopanska banka ad, Skopje	Tutunska banka ad, Skopje	Ziraat bankasi Skopje
2	Komercijalna banka ad, Skopje	Ohridska banka ad. Ohrid	IK banka ad, Skopje
3		Stopanska banka ad, Bitola	MBPR ad. Skopje
4		Alfa banka ad. Skopje	UNI banka ad. Skopje
5		Makedonska banka ad, Skopje	Radobank ad, Skopje
6		Invest banka ad, Skopje	Tetovska banka ad Tetovo
7			KIB ad. Kumanovo
8			Eurostandard banka ad. Skopje
9			Postenska banka ad. Skopje
10			Teteks-Kreditna banka ad. Skopje
11			Sileks banka ad. Skopje
12			ProKredit banka ad. Skopje
13			Inter. Privatna banka ad. Skopje

The two largest banks, Komercijalna and Stopanska, have been around for a long period of time. They have an established customer base and strong ties with the public administration. More than 54% of the total assets are concentrated in these banks.

TC Ziraat Bankasi Branch Skopje is a Branch of TC Ziraat Bankasi Ankara.

ProCredit Bank AD Skopje is a micro-credit bank that was established in 2003 with a special law.

Poshtenska Banka AD Skopje is a state owned bank that operates under special articles of the Banking Law. The Macedonian Post office, still a state-owned company, is the largest shareholder.



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Macedonian Bank for Development and Promotion is a state owned bank established under special law. It is a wholesaler bank that does not work directly with customers. In their portfolio of products they have export insurance and are considering offering factoring to the exporters.



ANNEX 4

WHAT IS FACTORING?

Introduction

The commercial activity of factoring is currently present in over sixty (60) countries and finances over US \$750 billion of domestic and international trade activity. Many of the world's largest financial institutions, such as General Motors, Hong Kong and Shanghai Banking Corporation and Fuji Bank own one of the over 1,500 factoring companies. Many smaller factoring companies are in countries such as Sri Lanka, Argentina, India, Iceland and Hungary. Factoring continues to be introduced into new countries as the regulatory framework and economic dynamics create supportive environments for the introduction of this rapidly expanding product.

In the broadest sense, factoring is used to finance a company's short-term accounts receivable (also, "accounts" or "receivables"). It is used in the manufacturing, distribution, and service sectors and combines the finance invoices and invoice administration.

Factoring Explained

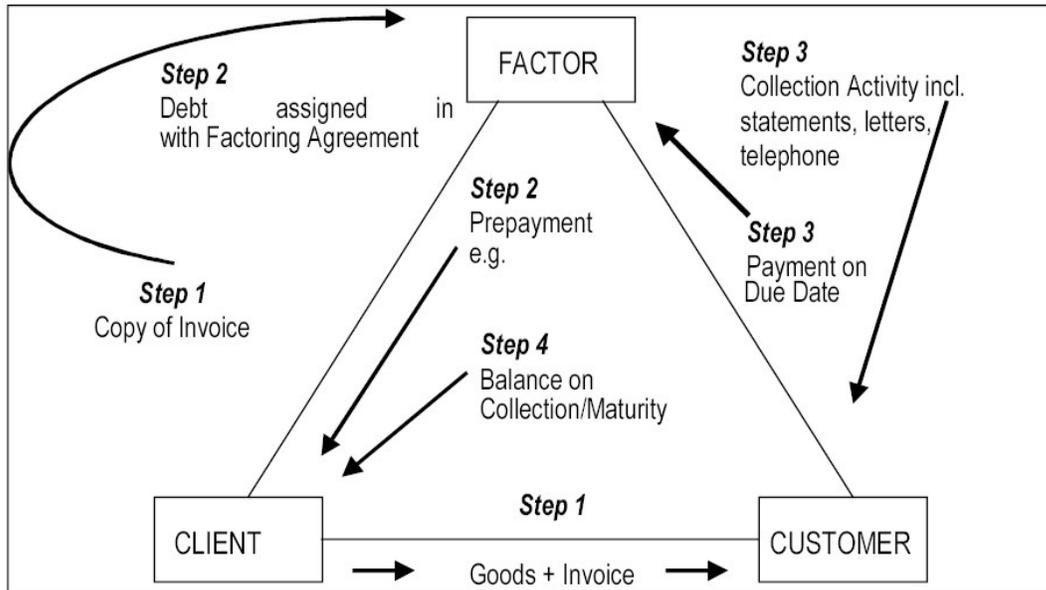
Factoring is the finance of accounts receivable for the purpose of creating liquidity and servicing. It usually includes a company's entire domestic or export accounts receivable not just a specific invoice. The services include bookkeeping, collection of debts, and the administration and reporting of the factoring activity. Factoring may include, in certain environments, credit underwriting and credit approval on buyers, and the corresponding bad debts that may occur. There are numerous variations of factoring: recourse factoring, non-recourse factoring, invoice discounting, full service factoring, and maturity factoring, to name a few. The critical point, however, is that factoring is very flexible and can "fit" most country's environment and the needs of many commercial enterprises. The product can be designed and deployed to comply with the needs of the marketplace.

The fundamental elements of factoring are:

- Finance (up to 80% of each invoice)
- Collection
- Bookkeeping
- Credit approval and the assumption of bad debts



A product is generally referred to as factoring if any two of these characteristics are present. In emerging economies, credit approval and the assumption of bad debts is normally not included due to the lack of available credit information.



Benefits of Factoring

There are many features of factoring; however, emerging economies such as Albania find that the liquidity created from the financing of the accounts receivable is the most important. Factoring turns a company's receivables into immediate cash. This accelerates the ability to grow by creating working capital that is liquid. The quality of the accounts receivable, general financial condition of the seller, and the degree of administrative involvement needed to service the accounts by the factor are some of the variables that govern the level of funding and the cost. Factoring will generally allow for greater flexibility and higher levels of funding than other forms of finance due to the factor's "hands on" involvement with the administration. The factor charges a fee for the service and an interest rate for the financing. Cash is available at the time an invoice is submitted to the factor. This allows a company to take advantage of supplier discounts, gives greater buying power, and creates available cash for most any need.



Factoring additionally offers important service benefits. The bookkeeping of accounts is professionally managed by the factor and relieves the company of the responsibility of administration. The factor may perform the function of collection from the buyer, as well. Buyers, in order to keep their good credit standing, will normally pay a factor promptly. The factor's business is centered on receivables and, therefore, can deliver a higher degree of efficiency and professionalism than individual companies.

The benefits of factoring are:

Financing:

- Flexibility
- Growth
- Immediacy of Funding
- Higher Levels of Funding (up to 80%)

Servicing:

- Bookkeeping
- Collection
- Administrative Reporting
- Faster accounts receivable turn
- Credit risk underwriting and bad debt assumption (in some cases)

Factoring is a dynamic tool for many companies. It fuels growth and assists in the creation of new jobs and new products. It will assist many of Macedonia's companies to compete on better terms with the world business community in the emerging global environment.



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Table 1A. Global Factoring Annual Volume by Country (million euro)

	1998	1999	2000	2001	2002	2003	Percent Change 1998-2003
Austria	1832	2007	2275	2181	2275	2932	60.0%
Belgium	4366	7630	8000	9000	9391	11500	163.4%
Cyprus	959	1120	1410	1554	1997	2035	112.2%
Czech Republic	468	780	1005	1230	1681	1880	301.7%
Denmark	2894	3360	4050	5488	5200	5570	92.5%
Estonia, Latvia, Lithuania	213	470	615	1400	2143	2262	962.0%
Finland	5230	5630	7130	7445	9067	8810	68.5%
France	44255	53100	52450	67660	67398	73200	65.4%
Germany	20323	19984	23483	29373	30156	35082	72.6%
Greece	596	850	1500	2050	2694	3680	517.4%
Hungary	115	144	344	546	580	1142	893.0%
Iceland	21	100	125	26	16	25	19.0%
Ireland	3957	6160	6500	7813	8620	8850	123.7%
Italy	75319	88000	110000	124823	134804	132510	75.9%
Luxembourg	0	0	0	0	197	257	..
Netherlands	17702	20500	15900	17800	20120	17500	-1.1%
Norway	3787	4260	4960	5700	7030	7625	101.3%
Poland	609	605	2085	3330	2500	2580	323.6%
Portugal	5545	7450	8995	10189	11343	12181	119.7%
Romania	20	37	60	98	141	225	1025.0%
Russia	0	0	0	0	168	485	..
Slovakia	179	160	160	240	240	384	114.5%
Slovenia	14	35	65	71	75	170	1114.3%
Spain	9936	12530	19500	23600	31567	37486	277.3%
Sweden	7677	7550	12310	5250	10229	10950	42.6%
Switzerland	1464	1300	1300	1430	2250	1514	3.4%
Turkey	4043	5250	6390	3947	4263	5330	31.8%
United Kingdom	84255	103200	123770	136080	156706	160770	90.8%
EUROPE TOTAL	295779	352212	414382	468324	522851	546935	84.9%
Argentina	1026	1481	1715	1017	71	70	-93.2%
Brazil	13620	17010	12012	11020	11030	12040	-11.6%
Canada	1863	1952	2256	2699	3100	3161	69.7%
Chile	1991	2600	2650	3123	3130	3500	75.8%
Costa Rica	162	226	258	208	210	185	14.2%
Cuba	0	185	108	113	120	93	..
El Salvador	0	0	0	123	157	102	..
Mexico	2519	3550	5030	6890	6340	4535	80.0%
Panama	0	11	220	220	0	160	..
U.S.A.	70059	88069	102268	101744	91143	80696	15.2%
AMERICAS TOTAL	91240	115084	126517	127157	115301	104542	14.6%
Israel	108	219	460	429	354	190	75.9%
Lebanon	0	0	0	10	22	35	..
Morocco	187	57	45	50	190	160	-14.4%
Oman	14	21	30	36	29	10	-28.6%
Saudi Arabia	0	0	0	150	100	50	..
South Africa	3957	5340	5550	5580	5860	5470	38.2%
Tunisia	54	73	60	171	153	210	288.9%
United Arab Emirates	0	0	0	0	0	37	..
AFRICA & MIDDLE EAST TOTAL	4320	5710	6145	6426	6708	6162	42.6%
China	11	31	212	1234	2077	2640	23900.0%
Hong Kong	1294	1800	2400	2690	3029	3250	151.2%
Indonesia	28	33	3	0	1	1	-96.4%
India	174	257	470	690	1290	1615	828.2%
Japan	38980	55347	58473	61566	50380	60550	55.3%
Malaysia	687	805	585	842	610	718	4.5%
Singapore	1510	1970	2100	2480	2600	2435	61.3%
South Korea	17149	15120	115	85	55	38	-99.8%
Sri Lanka	38	62	99	115	110	102	168.4%
Taiwan	1004	2090	3650	4511	7919	16000	1493.6%
Thailand	715	1010	1268	1240	1274	1425	99.3%
ASIA TOTAL	61590	78525	69375	75453	69345	88774	44.1%
Australia	3319	5100	7320	7910	9527	13716	313.3%
New Zealand	162	184	100	410	465	263	62.3%
AUSTRALASIA TOTAL	3481	5284	7420	8320	9992	13979	301.6%
WORLD TOTAL	456410	556815	623839	685680	724197	760392	66.6%



SEED

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Table 1B: Global Factoring– Relative Importance

	Domestic Volume (2003)	International Volume (2003)	Percent International (2003)	Total Volume 2002/GDP 2002	Domestic Credit to Private Sector 2002/GDP 2002	Exports of Goods and Services 2002/GDP 2002
Austria	2598	334	11.4%	1.2%	106.4	52.1
Belgium	9500	2000	17.4%	4.0%	76.3	82.3
Cyprus	2000	35	1.7%	20.7%	125.4	..
Czech Republic	1600	280	14.9%	2.5%	33.4	65.2
Denmark	3570	2000	35.9%	3.2%	146.4	44.9
Estonia, Latvia, Lithuania	2012	250	11.1%	7.8%	21.8	58.2
Finland	8545	265	3.0%	7.2%	60.0	38.1
France	68200	5000	6.8%	4.9%	87.2	27.1
Germany	27131	7951	22.7%	1.6%	118.9	35.5
Greece	3500	180	4.9%	2.1%	67.1	20.5
Hungary	1080	62	5.4%	0.9%	35.3	64.5
Iceland	0	25	100.0%	0.2%	100.5	39.7
Ireland	8800	50	0.6%	7.4%	110.3	..
Italy	124510	8000	6.0%	11.9%	82.3	26.9
Luxembourg	237	20	7.8%	1.0%	111.4	145.3
Netherlands	16000	1500	8.6%	5.0%	147.9	61.7
Norway	6800	825	10.8%	3.9%	86.3	41.5
Poland	2450	130	5.0%	1.4%	28.8	28.0
Portugal	11828	353	2.9%	9.8%	147.9	..
Romania	90	135	60.0%	0.3%	8.3	35.4
Russia	470	15	3.1%	0.1%	17.6	34.7
Slovakia	296	88	22.9%	1.1%	40.6	72.8
Slovenia	140	30	17.6%	0.4%	39.2	57.9
Spain	36443	1043	2.8%	5.1%	111.1	28.5
Sweden	9650	1300	11.9%	4.5%	..	43.3
Switzerland	1298	216	14.3%	0.9%	159.0	44.2
Turkey	4200	1130	21.2%	2.4%	14.9	29.7
United Kingdom	158270	2500	1.6%	10.5%	142.6	25.8
EUROPE TOTAL	511218	35717	6.5%	5.4%		
Argentina	65	5	7.1%	0.1%	15.3	27.7
Brazil	12000	40	0.3%	2.6%	35.5	15.8
Canada	2131	1030	32.6%	0.5%	82.2	..
Chile	3300	200	5.7%	5.1%	68.1	35.9
Costa Rica	180	5	2.7%	1.3%	30.1	42.4
Cuba	30	63	67.7%
El Salvador	100	2	2.0%	1.2%	..	26.7
Mexico	4435	100	2.2%	1.0%	12.6	27.2
Panama	160	0	0.0%	0.0%	97.6	28.2
U.S.A.	77496	3200	4.0%	0.9%	140.6	9.8
AMERICAS TOTAL	99897	4645	4.4%	1.0%		
Israel	20	170	89.5%	0.4%	97.8	37.2
Lebanon	35	0	0.0%	0.1%	90.8	13.9
Morocco	130	30	18.8%	0.6%	54.4	32.3
Oman	10	0	0.0%	0.1%	38.6	56.8
Saudi Arabia	50	0	0.0%	0.1%	58.2	40.8
South Africa	5350	120	2.2%	5.9%	131.7	34.0
Tunisia	160	50	23.8%	0.8%	68.6	44.8
United Arab Emirates	36	1	2.7%	0.0%	55.9	..
AFRICA & MIDDLE EAST TOTAL	5791	371	6.0%	1.3%		
China	2400	240	9.1%	0.2%	136.5	28.9
Hong Kong	2000	1250	38.5%	2.0%	150.1	150.8
Indonesia	1	0	0.0%	0.0%	22.3	35.4
India	1500	115	7.1%	0.3%	32.6	15.2
Japan	60000	550	0.9%	1.3%	175.3	11.1
Malaysia	690	28	3.9%	0.7%	146.1	114.1
Singapore	2060	375	15.4%	3.1%	115.5	..
South Korea	0	38	100.0%	0.0%	115.6	40.0
Sri Lanka	94	8	7.8%	0.7%	28.5	36.2
Taiwan	11700	4300	26.9%	2.9%	..	53.8
Thailand	1400	25	1.8%	1.1%	102.5	64.7
ASIA TOTAL	81845	6929	7.8%	1.0%		
Australia	13656	60	0.4%	2.4%	..	19.6
New Zealand	250	13	4.9%	0.8%	118.1	33.2
AUSTRALASIA TOTAL	13906	73	0.5%	2.2%		
WORLD TOTAL	712657	47735	6.3%	2.5%		

Source: Factors Chain International, World Bank.