

Small and Micro Enterprise Taxation In CIS Countries – issues and challenges

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About CIS countries

- Transformation from centrally planned to market economies was a massive experiment in politics with substantial impact on the social and economic fiber of these countries
- Lasting impact on institutions, freeing of state-owned enterprises
- Perception of taxes
- The political transition has had its impact on the tax system
- Lack of experience in dealing with private sector
- Issues with movement of people persists in many CIS countries

About SME taxation

- Small and micro enterprises form the bulk of the taxpayer base in all countries 85% –95%
- Yet their contribution to revenue is miniscule
Typically 1%–3% of total revenue
- Typically defined, they are all businesses that are below the threshold for VAT registration
- Very heterogeneous group
 - street vendors
 - artisans
 - subsistence farmers
 - small individual entrepreneurs
 - professionals
 - small shopkeepers and businesses with several employees.

Why are SMEs important

- The tax treatment and accurate registration of SMEs important beyond simple revenue generation.
- Important for: –
 - generating employment
 - improving horizontal and vertical equity
 - increasing the economic efficiency
 - enhancing the overall tax morale
 - secure their participation in the political process
 - improve government accountability and transparency
 - contribute to overall state building
- ▶ Negotiating around taxes is a unique opportunity to build more accountable, and transparent public institutions

SME taxation regimes in CIS countries

- ▶ Patent
- ▶ Presumptive taxation based on indicators
- ▶ Turnover based tax
- ▶ Cashflow based taxation

SME taxation in CIS countries – Patent

- typically used for micro enterprises as a substitute for VAT + income tax + social contribution, etc.
- fixed fee varying across economic activities – list could get complex
- regardless of profitability or turnover
- usually the fee is very small to reduce evasion
- encourages business to enter the formal economy
- the tax is regressive
- transition to normal tax regime may become difficult
- Requires little or no bookkeeping

SME taxation in CIS countries – Presumptive taxation based on indicators

- used in place of income taxation, sometimes also VAT
- physical indicators or financial information used as proxy for income
- indicators are activity and location specific – hence complex, e.g., regime du forfait in France
- lack of comparability across sectors
- definition of small business may be based on turnover, assets or # of employees
- requires minimal bookkeeping
- problem of distortions

SME taxation in CIS countries – Turnover based

- tax is a percentage of gross receipts
- mainly used in place of income taxation
- use of turnover provides a link to VAT where also turnover is used for VAT registration
- may have no relation to profitability –effective tax rate will vary inversely with profit margins
- cascading effect
- requires simple bookkeeping

SME taxation in CIS – Cash flow based

- takes into account gross receipts and expenditure
- requires cash-based single entry bookkeeping of cost and receipts instead of accrual based accounting
- capital purchases are expensed; so no need for to keep depreciation tables
- mainly used in place of income taxation
- effective tax rates are equal across sectors

Country example –Issues with SME regime in Kazakhstan

- The thresholds for presumptive taxation are unusually high for both the patent and the simplified regimes.
- The threshold of the simplified regime for corporate firm is substantially higher than the VAT registration threshold
- In 2009 only 2% of all active individual taxpayers paid income tax
- In 2009, only 1,446 non-corporate businesses declared a turnover above the threshold of the simplified tax regime.
- Patent contributes less than 0.01% to direct tax revenues
- Simplified regime contributes 1% to direct tax revenues
- Hardly any businesses voluntarily migrates from the small into the medium business category
- The regime is not allowing small businesses to grow to medium and large businesses. Bad for economic growth.

Issues relating to SME tax regimes

- ▶ The current regime is being abused by businesses that should be filing in the normal regime
- ▶ Create incentive for larger firms to split into small firms because gap between SME and normal regime is significant
- ▶ Existing owners can create new small firms instead of consolidating expansion
- ▶ Where the difference between SME regime and wage tax is significant, firms have a tendency to hire independent consultants
- ▶ Creates avenues for related parties that have large business to use small business for tax avoidance, e.g.,
 - loan to the small filial instead of payments
 - delay payments to reduce cash receipts
- ▶ Despite the ease of compliance, the lack of verifiability may be a great incentive for staying in the shadow economy

Challenges for tax authorities

- **Challenges**
 - Large number of firms with low revenue potential
 - Evasion widespread, resources constrained
 - Low level of information, low data quality
 - Need to combine compliance with advisory support
- **Compliance strategy**
 - Identification of noncompliant sectors
 - Determination of industry benchmarks and performance benchmarks – cost of goods/turnover, labor costs/turnover,
 - Identification of outliers from norm
- **Goal**
 - No need for perfectly accurate determination of turnover
 - Identify medium business hiding as small
 - Identify serious cases of evasion

Options for reforms – policy

- ▶ Establish a reasonable threshold to ensure that medium-size businesses are subject to the normal taxation regime
- ▶ Clear definition of thresholds to distinguish micro from small and small from medium sized businesses.
- ▶ Turnover should be used as the single criteria for these thresholds.
- ▶ The small business regime threshold should be aligned with the VAT registration threshold.
- ▶ Businesses requiring VAT registration should be subject to income tax according to the normal regime.
- ▶ Professional activities should be excluded from SME regime
- ▶ Simplified VAT and CIT filing and payment obligations are core areas of reform for medium sized businesses – this will facilitate small business transition to grow into medium size and limit abuse.

Options for reforms – administration

- ▶ Focus on tax audit, taxpayer service and information matching are needed in order to address the special requirements of SME compliance management.
- ▶ Tax audits of presumptive taxpayers should be based on clear risk analysis aimed at identifying abuse of presumptive tax by larger taxpayers.
- ▶ Special risk parameters need to be defined to detect cases of major under-declaration of turnover.
- ▶ Special micro and small business assistance and advisory program with a major focus on improving bookkeeping standards and practices are very useful in encouraging compliance
- ▶ International experience from OECD countries are helpful for the design of such programs.

Key risk sectors among SMEs in OECD countries

Australia	Belgium	Canada	Sweden	US
Construction Transport Restaurant Beauty salons Cleaning Clothing Car retailers Art & antique	Construction Transport Gambling Cleaning Car retailers Diamond Dentist E-commerce	Construction Hospitality Real estate Beauty salons Taxi firms Agriculture	Construction Restaurant Beauty salons Taxi firms Scrap metals E-commerce Labor agents	Construction Restaurant Health care Medical professionals Real estate Car retailers

THANKS A LOT!!!