

# Small Business Taxation in Transition Countries

No Easy Fixes

# Goals of Small Business Tax Regimes

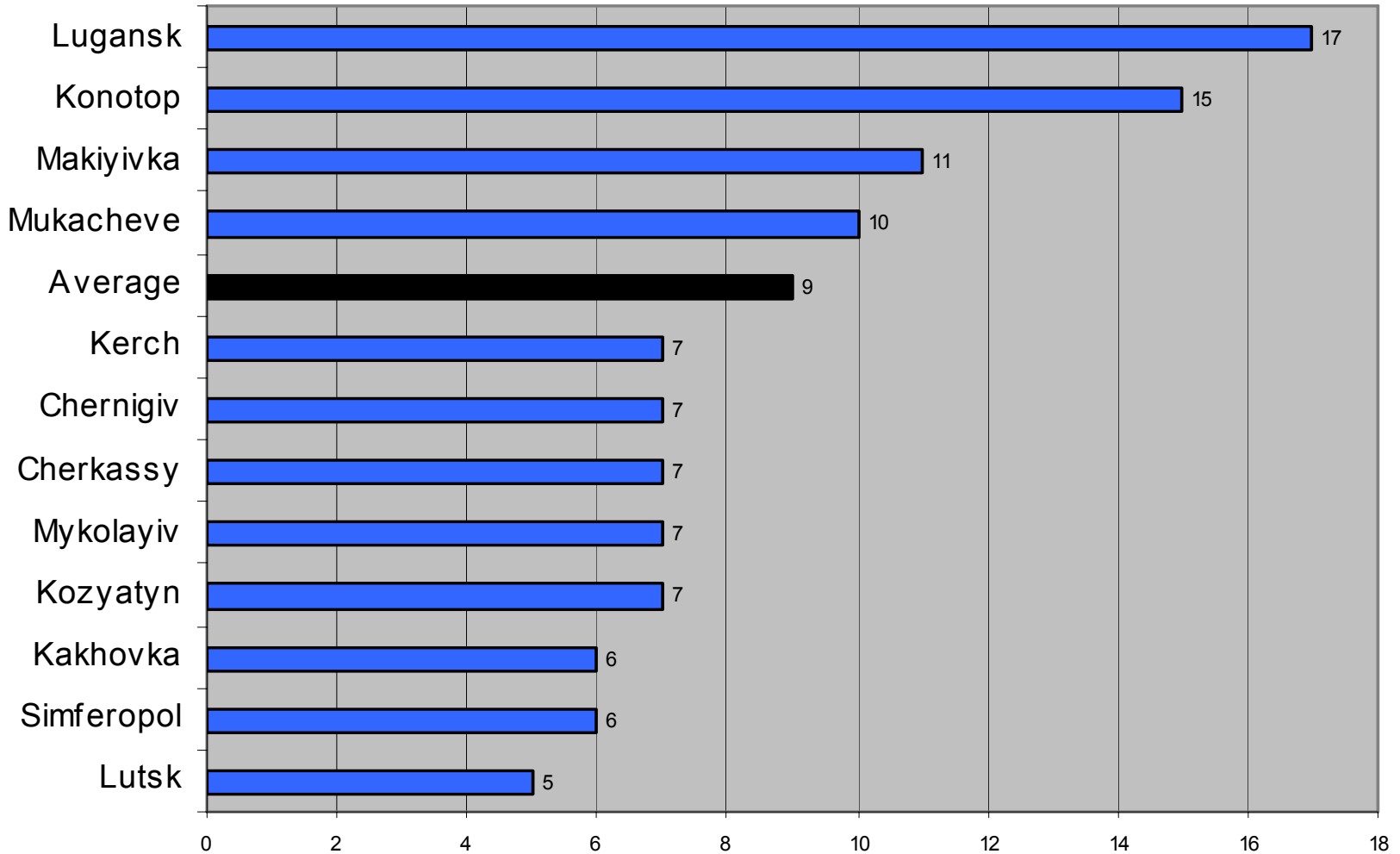
- Encourage formality
- Encourage business growth and employment
- Improve tax compliance and revenue

# But Goals tend to conflict

- Encourage formality
  - Simplicity ( $\neq$  fairness)
  - Low tax burdens
- Encourage Growth
  - Low tax burdens
  - No disincentives to graduate
- Improve Compliance
  - Simplicity (and ability to learn bookkeeping)
  - Stability

# Ukraine

## Number of Taxes and Duties Paid by Small Businesses



# Broadening the Tax Net

**Table 5: Ukraine's Presumptive Tax System**

Year	Unified/Single tax		Number of special trade patents purchased (units)	Number of fixed tax payers ('000)
	Legal entities ('000)	Natural persons ('000)		
1999	28.6	66.1	16,873	318
2000	66.6	182	7,411	327.4
2001	91.7	345.1	6,986	339.3

Source: Barbone and Sanchez (2003)

# ... but still no panacea

**Table 6: Registered Enterprises in the Presumptive Tax System**

Enterprise size	Number of employees	Estimated number of enterprises	Estimated employment	Estimated percentage of registration	Estimated non-registered employment (in %)
	0 (Sole entrepreneur)	2,651,433	2,651,435	24.6	75.4
Small	1 to 5	148,976	516,947	37.6	62.3
	6 to 10	104,608	850,460	94.1	5.9
	11 to 50	123,757	3,189,226	99.5	0.5
Medium	51 to 250	33,169	4,206,444	99.5	0.5
Large	more than 250	10,851	9,822,542	99.4	0.6

# Types of Systems

- Turnover tax or gross income tax
- Presumptive Tax based on indicators, e.g.
  - Type of business
  - No. employees
  - Location
  - Etc.
- Patent (e.g., operating license for fee)
- Questions of
  - Which taxes are replaced?
  - Who can be included in the SBT regime?

# Turnover or Gross Income Tax

- Pros
  - Good introduction to basic accounting
  - Smooth transition to regular tax system
- Cons
  - Hard for illiterate or semi-literate entrepreneurs
  - Encourages evasion and under-reporting

# Presumptive Tax

- Pros
  - Should be based on objective, verifiable indicators
  - Can be tailored to fit circumstances of different types of businesses and locations
- Cons
  - Usually becomes very complex
  - No easy transition to normal tax regime

# Patent

- Pros
  - Very simple
  - Good for illiterate entrepreneurs
- Cons
  - Very unfair (too expensive for some businesses and too generous for others)
  - No easy transition to normal tax regime

# Guidance

- First priority should be to improve the normal tax regime (no regrets)
  - Simplify
  - Broaden base, lower rates
  - Indicators for compliance, profits, revenues
- Next consider whether a SBT regime might be necessary or desirable
- If so, establish goals and strategy for SBT regime, as well as performance indicators

# Tailor strategy to goals

- Lowest income countries: simplicity to encourage formality and bring businesses into culture of compliance
  - Patent
- Middle income countries: encourage graduation
  - Turnover or gross income tax

# But don't expect many thanks

***Question: Can you tell me how problematic current tax rates are for the operation and the growth of your business?***

<b>Country</b>	<b>Moderate or major obstacle</b>
<b>Albania</b> SME	48.3%
Large businesses	55.5%
<b>Bulgaria</b> SME	64.2%
Large businesses	43.7%
<b>Russia</b> SME	55%
Large businesses	51.5%
<b>Ukraine</b> SME	64.3%
Large businesses	58.3%

# Who Plays What Role?

- IMF/WB PREM – Overall fiscal reform agenda
- PSD/FIAS/SME/DB – Supporting role, focusing on impact of tax regime on businesses, METR, compliance cost surveys
- Facilities – Assistance in documenting views of businesses, supporting business associations, and education campaigns aimed at domestic business community