

The taxation of SME: Policy against administration?

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Frame the issue in 2 key policy questions:

- What are SME?
 - Very broad – and often badly defined concept
 - Sometimes really means “new”, “inefficient”, ...
- What is so different about such SME and what does it imply for taxation?
 - Should they be taxed more or less?
 - Should they be taxed differently?

Common claims: SME's are...

- engines of growth and jobs
- more innovative
- disadvantaged on the capital markets
- a tool of social policy (by reducing poverty)

... but all claims are problematic!

Some selected issues:

- SME's could equally well be less efficient (trade, IO literatures)
- gross/net job accounting
- heterogeneity of companies
- over-optimism of small entrepreneurs
- business taxes as a social policy tool?
- other better non-tax instruments...
...for frequently non-tax problems!

The data speak a clear language...

- Empirical regularity
 - A relatively small proportion of large firms typically accounts for a very large proportion of collected tax revenues

... or do they?

- Data on observed rather than potential revenue likely introduces bias.
 - Observed concentration can signal many different things (e.g. Auriol-Warlters)
 - Withholding, reverse-charge... and beyond.
- Tax incidence
 - Paying is not equal to supporting the burden of the tax. (e.g. VAT system with threshold can be a subsidy to small firms)

VAT: simple optimal tax results

- Define objectives
 - (efficiency, equity, taxpayer citizenship,...)
- First best with no costs
 - Universal VAT or final consumption tax desirable
 - Neutral for allocation of resources
 - Complements: excises, expenditure

VAT: simple optimal tax results (2)

- With administration and compliance costs:
VAT threshold
 - Higher for more costly administration and compliance of VAT, when less need for public funds, or in presence of lower ratio of value added to sales.
 - Also higher if the alternative (simplified) tax below threshold easier to collect and generating more revenues!

When integrating with other taxes

- Some issues get reinforced
 - Administrative and compliance cost savings
 - Distortions, cascading of simplified tax, strategic behavior...
- Others appear...
 - Potential impact on employment relations.
 - Employed versus self-employed
 - Labor versus capital income
 - Social contributions are delicate: e.g., benefit linkages

What role for simplified or synthetic tax regimes ?

- Possible role for business license fees for micro-enterprises (e.g., flat business license fee)
- Turnover/cash-flow based regimes (e.g., Egypt)
- However...
 - It is illusionary to think that a synthetic tax can mimic a full set of tax instruments
 - It should be recognized that new distortions created
- Ultimately, we face a trade off between simplicity and revenue loss/distortions.

Summing up

- Need to recognize the heterogeneity of SME.
- No uni-dimensional classification.
- Incidence and behavioral considerations matter.
- Introducing a threshold inevitably generates strategic incentives for firms.
- Difficulty of finding a “simple” SME tax that mimics full set of taxes...