

## IMPROVEMENT OF SMALL BUSINESS OWNERS TAXATION

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### Abstract

The taxation system's core role is that of an economic regulator, while the taxation service acts as a link between the taxpayer and the government. The Russian Federation's taxation norms have a clear fiscal character. Our research compares and analyses the special taxation regimes used by small business owners in 2013 – 2018, reveals the key reasons behind the difficulties in the use of one of the taxation regimes, a flat tax on an imputed income. The tax burden is one of the reasons. We assess an alternative mechanism of a tax for the self-employed used since 2019 for small business owners. The key advantages of this special regime include an automatic tax deduction from the calculated taxation base with the help of a mobile application with simple registration. This feature will help influence the development of this economic sector because it is a factor in the national wealth amassing and will trigger higher budget incomes to the budgets of all levels.

**Keywords:** Taxation, Special taxation regimes, Tax burden, Small business owners, Small business

### 1. INTRODUCTION

The current taxation system structure is primarily characterized by the importance of interrelations between all its elements and changes in the elements under the influence of different factors, both internal and external (Alesina, and Giuliano, 2011). This makes the Russian taxation system conspicuous for its dynamic, not static character, which factors in territorial subordination, including the managerial levels of tax federalism. This type of division is typical of most countries with a federal center and regional levels (for example, regions, municipalities, etc).

At that, the fiscal policy of the emerging markets states applicable to small business, including solopreneurs, is chiefly aimed at improvement of business conditions, including their simplification in the last few years (Korableva, 2019).

At the same time, one of the key factors with a direct influence on the character and development of small and medium sized business is its low involvement in the economy because of the inefficient crediting

mechanisms, restricted access to production facilities, administrative barriers, etc. The tax conditions are conspicuous for constant changes. For the Russian Federation, it means:

- a) undeveloped mechanisms of financial support and risk insurance, the absence of relevant co-financing mechanisms (Becker, 2016);
- b) restricted access to producing facilities and property of factories, the absence of reliable social protection, administrative barriers (Kader, 2010);
- c) an inefficient taxation system, including changes in the fixed insurance payments, which had a clear rising trend in 2014-2019, which have a direct influence on the amount of the fiscal burden of a small business owner.

## **2. THEORETICAL BACKGROUND**

### **2.1. Literature Review**

Looking back, we will see that A. Laffer defined the tax burden as the maximum tax payments of companies to the government (Brown, and Hunter, 1999). At that, modern economists' researches make the tax burden part of a free income, which can be spent to satisfy state needs. However, works of some economists when presenting the fiscal burden, focus on direct correlation between it and the level of financial and economic restrictions of the government (Edlin, 2007, Schwamm, 2018). Consequently, introduction of such restrictions via additional payments in the form of taxes has a direct influence on the withdrawn monetary resources of the businessmen able to bring economic gains (Heim, 2010).

When researching the notion of a tax burden at the macroeconomic level, we can single out the total effect from taxes on the country as well as on borrowers (Vlasov, 2018). The economic restrictions, which appear after payment of all taxes, withdraw the company's current assets prohibiting their use for further development (Kopczuk, 2005). Saez, E. (2010) is of the same opinion expressed in his research, where he singles out the aggregate impact of taxes paid to the budget of a country as a share of tax payer's revenue when calculating the tax burden Roman, C., Congregado, E., and Millan, J. M. (2011). By way of summary of a state's fiscal policy, we can define the economic category of a tax burden as a ratio of paid taxes to the total national product (Kluge, 2015).

The current taxation system principles include the basic approaches used in most countries, which take into consideration the following:

- a) equitability of the tax burden depending on the tax payer's category (Carrillo, 2017) and the industry (Doerrenberg, 2014);
- b) logic distribution of levying and paying taxes according to territorial subordination as the taxes are split into direct and indirect (Gersovitz, 2004, Niehaus, 2018);
- c) the optimal tax burden for the tax payer based on the establishment of corresponding taxation elements (Fack, 2016), including obligatory basic elements and non-obligatory elements (Garven, 2014);
- d) effectiveness of tax controls when cooperating with the subjects to taxation (Guthmuller, 2014), including some of their categories – small business and solopreneurs (Bettinger, 2012).

This explains the goal of our research – widening of scientific and practical approaches to equalization of the tax burden for the small business owners, who use special taxation regimes of the Russian Federation.

### **2.2 Data Analysis**

The most important problems of small business subjects can be grouped into producing, legal, tax and labour problems. According to a Rosstat research, the labour force in the Russian shadow economy amounted to 16 mln to 40 mln in 2018, and the small business owners, who halted their operations, make a significant part of them. A research of dynamics of registered small business owners numbers in 2013-2018 largely reflects the following statement: the numbers of registered small businesses rise steadily, it is characterized by trend equation  $y = 0,0054x + 0,0094$ ). Growth in the numbers of those who stopped their business activities in the same period can be described by function  $y = -0,0014x + 0,0802$ , which points to a falling share of small business owners, who ceased their activities. However, the absolute number of closed small businesses continues to grow, which is a worrying factor. For instance, the ratio of newly registered small business owners to the small business owners and farmers who ceased their activities amounted to 1,104 to 1,568 as of July 1, 2019 compared to the same period as of July 1, 2014 (fig. 1).

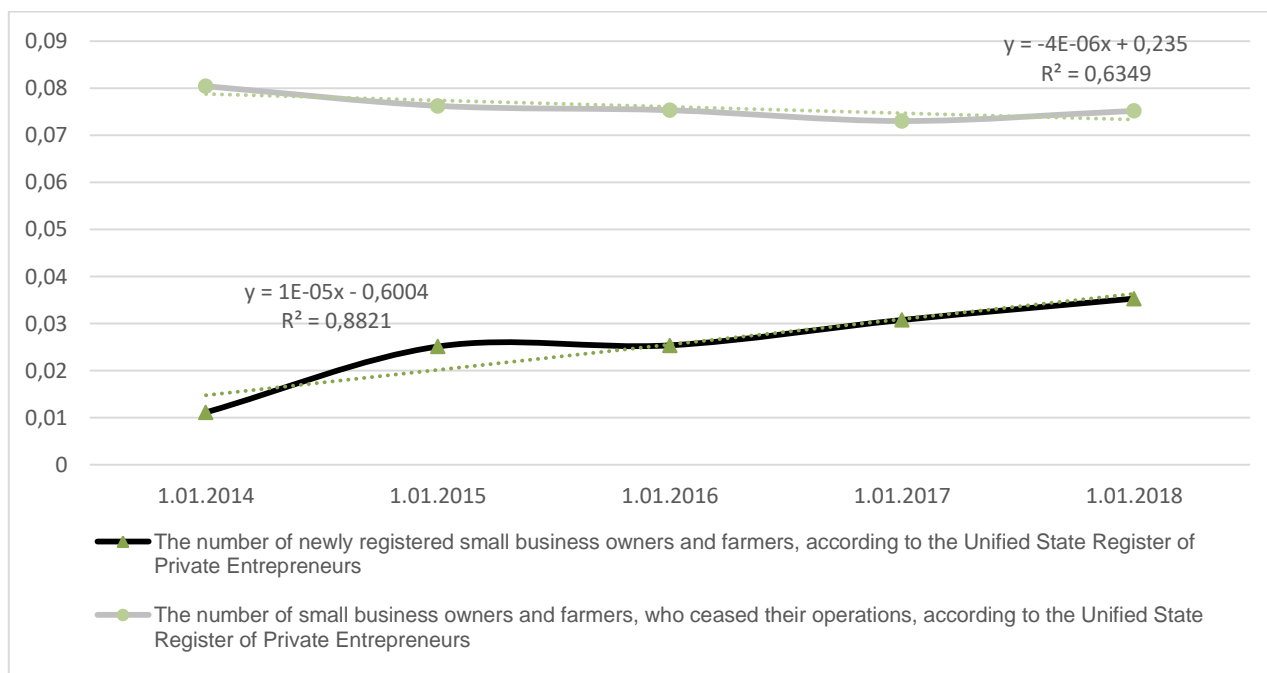


Fig. 1. The ratio of registered small business owners to those stricken off the register in the Russian Federation in 2013-2018.

The most important factors impacting the tax burden for the small business owner are:

- The volume of produced goods, sold goods (works, services) taking into account the special features of indirect taxation;
- Changes in the size of taxation bases, tax payment planning during tax optimization;
- The applicable taxation regime (general or special).

undoubtedly, the need to pay a fixed payroll tax set regardless of real operations is one of the key reasons behind the rise of the taxation base, which prompted the businessmen to stop their activities. We should note that small business owners, apart from paying taxes, also pay a fixed payroll for themselves as an obligatory pension insurance (an equivalent of U.S.\$560 as of 2019). This figure increases on an annual basis. If revenue from operations for a calendar year exceeds U.S.\$4,600 in the national currency equivalent, the businessman has to pay an additional contribution of to the pension insurance fund in the amount of 1% (of income), but no less than the limit (U.S.\$3,700 in 2019). At the same time when calculating the additional contribution to be paid for a taxation period, the base is calculated differently:

- A personal income tax (the general regime) as the difference between the income and professional tax deductions (Golubtsova, 2019);
- A simplified taxation system (a special taxation regime) when choosing taxation object "income less costs" – only for the income (Sharafutdinov, 2018);
- A flat imputed tax (a special taxation regime) depending on the size of an estimated imputed tax for a calendar year (Verter, 2019).

### 2.3 Results and Discussion

The applicable methods of calculation of the tax liabilities under the special taxation regimes largely factor in the special features of some groups of economic subjects as compared with the applicable general taxation regime. The presumptive assessment taxation uses simpler rules of tax calculation and payment. We can break special taxation regimes in international practice down as follows:

- Simplified taxes (presumptive assessment taxes);
- The forfeit system;
- Imputed taxes;
- Patent taxation.

The simplified taxes do not usually presume accounting book keeping and are simple enough for the tax payer and for the government's tax management. At that, this type of tax partially replaces the taxes paid under a general taxation regime.

The bulk of the countries, which use simplified taxation regimes, and also the Russian Federation, uses flat tax rates for all types of business activities (Roman, 2011). However, this method overlooks the following – the tax payer's profit, which can differ greatly depending on the type of activity and on the industry. The presumptive assessment taxes assess the potential income of small business subjects better than the simplified taxes calculated on the basis of real revenue. At the same time, the use of imputed taxes is complicated, and time consuming, while the accuracy of potential profit calculations by the type of activities and other criteria is unreliable.

The Russian Federation restricts the use of a flat imputed tax for some types of activities after 2021 and imposes compulsory taxation ensuring budget tax revenues until the end of the period. According to the Russian Federation's Tax Service, the sum of calculated imputed tax increased by 5.8% as of January 1, 2018 compared with the same period in 2014, while of the number of small business owners using this special taxation regime fell significantly, by 11.3%. At that, the basic income indicator for the taxation base did not change. It is the auxiliary coefficients of imputed tax calculation that were adjusted on an annual basis as well as the regional aspect of activities, which are differentiated from 0.001 to 1 (fig. 2).

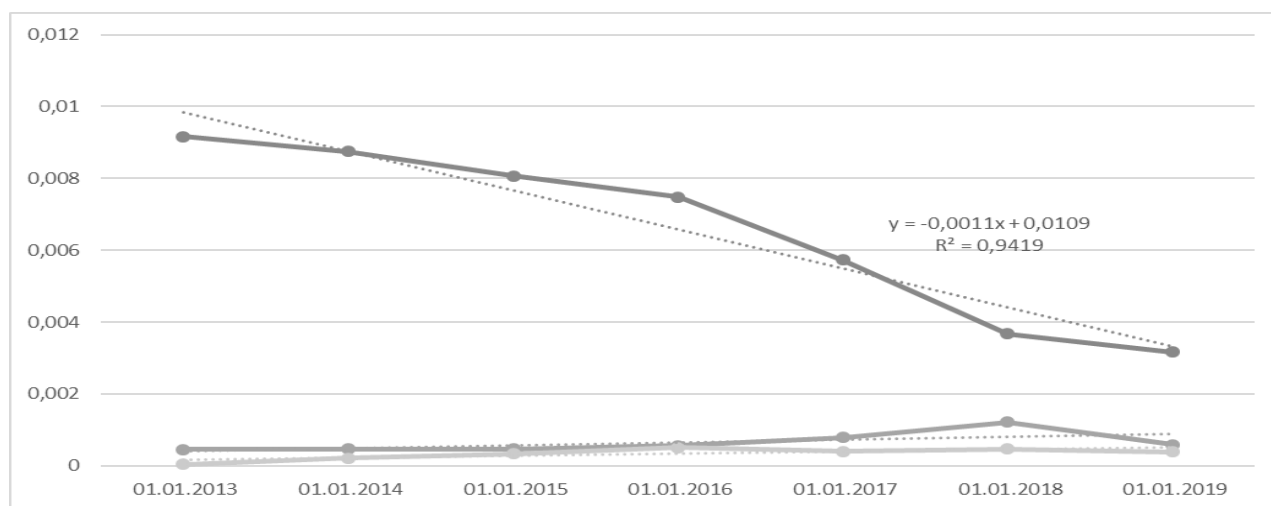


Fig. 2. The ratio of tax revenue under the special taxation regimes to the total tax revenue of the Russian Federation budget in 2013-2018.

At the same time the practical use of the imputed tax in combination with other special taxation regimes, including the patent system, has several features making its use difficult – control by the small business owners of the average number of staff per calendar quarter so that it does not exceed the limit of 100 employees. Consequently, the small business owner has to keep separate accounting for property, obligations and operations, because the limit under the patent system does not exceed 15 hired people for different types of activities (Eslava, 2010).

The introduction from January 1, 2019 of a new special regime in the form of a professional income tax (further PIT) as an alternative to the imputed tax by way of experiment covers both operations of small business owners and individuals restricted to the territories of the Russian Federation subjects: Moscow, the Moscow and Kaluga regions, and the Republic of Tatarstan (Golubtsova and Zvereva, 2019). The key advantages of this regime include legislative prohibition on the increase of the tax rates or the ceiling for revenues for the next ten years. The common restrictions for the use of PIK by the potential tax payers are:

- Some types of business activities (the sales of excise goods, the resale by individuals of goods and property rights, except their use for personal and domestic needs, intermediary activities, or employees with labour contracts and some others).
- The activities of small business owners, who use other special regimes (simplified and patent taxation).

The sphere of the PIK use is very wide – revenues from the sales of goods (works, services, property rights), capped by a maximum sum of U.S.\$37,000 in the national currency equivalent (Vlasov, 2018). At that, the taxation object includes both the volumes of sold goods (works, services), which is an element of indirect tax

VAT (Vlasov, Sinchukov 2019), and the profit liable to a direct personal income tax for the first time in the Russian practice. At that, the use of PIK is good for any type of business activities, excluding the profits received from:

- a) The sale of immovable and movables, property rights securities (liable to the personal income tax with the possibility of tax deductions);
- b) State and municipal employees (except profit from renting out residential premises);
- c) Business activities under a simple partnership agreement (joint activities or trust property management);
- d) Provision by individuals of services (works) under the civil law contracts, if the client is the employer of such individuals or the persons who were their employers less than 2 years ago;
- e) Arbitration management, mediation activities, assessment activities, notary's activities with private clientele, lawyer's activities and some others.

## **2.4 Conclusion**

The clear advantage of the new PIK regime for the small business owners is an automatic tax deduction from the calculated tax base by the taxman. The deduction is capped at U.S.\$160 (offered once during the whole period of operations), while the minimal size depends on the tax rate: 4% on the profit from sales of goods (works, services), property rights to individuals, 6% to the small business owners and companies respectively. It is provided within a calendar year for any period. Thus, the profit taxable for PIK taking into account the tax deduction may fall to 3 - 4% of the tax base depending on who received work (a service) or bought goods (individuals or companies). However, there are also clear disadvantages of the special PIK regime for the taxpayer:

- a) The U.S.\$160 limit on the tax deduction for the whole period of business operations with a simultaneous taxation of profit from the sales at 4 or 6%. In this case, the small business owners using the simplified taxation system will be better off paying a 1% minimal tax on the real annual profit and getting a guarantee of a future pension. The new regime does not require payments to the obligatory pension insurance system.
- b) A great probability of the use of PIK by organizations, not small business owners, who would attract freelancers to do work/offer services. In this case, the companies would save no less than 13% of the payments (there will be no need to act as a tax agent for the personal income tax) and no less than 20% (the key profit tax rate) of the payments, which fully reduce the tax base for the profit tax. In this case the limit is only the size of the payments, which should not exceed U.S.\$37,000 per individual who received a profit.

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