

## Tax Legislation as External Factor of Small and Medium-scale Business Success in Russia

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### Abstract

The purpose of this report is to present the study results of the external factors influencing the success of small and medium-scale businesses in Russia. At the same time, the factors of success are studied from the point of view of such an impact subject as a state. The influence of the state as a success external factor of small and medium-scale business is examined through the current tax legislation. The macroeconomic statistical data of the Ministry of Finance, the Federal portal for small and medium-sized enterprises of the Ministry of Economic Development of the Russian Federation, the Federal Tax Service were used in the study. To process the data general scientific methods of research such as comparative analysis, graphical analysis, synthesis, grouping and generalization were used. The following results were obtained. Firstly, the external factors to influence the success of small and medium-sized businesses in the context of the tax legislation have been classified into the economic, legal, social and organizational factors. Secondly, the impact of the economic (external) success factor of small and medium-scale enterprises in Russia is viewed through the tax burden, and tax benefits. Thirdly, the current tax benefits for small and medium-sized Russian business in the present-day economic conditions have been accentuated to and clarified. The results obtained will enable us to evaluate the degree of each identified external factor influence on the small and medium-scale business success in the further studies.

**Keywords:** small and medium-scale businesses, small-scale business, medium-scale business, business successfulness, external factors, tax policy, tax legislation, tax burden, tax benefits.

### 1. Introduction

Numerous factors make an impact on the success of small and medium-scale business. These factors can conventionally be divided into two groups: internal and external ones. The internal factors, in turn, depend on the enterprises themselves and set the business activities of the enterprise. The external factors are beyond the company's influence and they are created by the developments independent of the company. In the current economic conditions, external factors impact on the success of small and medium-sized businesses is more pronounced. The external factors are split into economic, legal, social, political, technological (science and technology) and organisational. The subjects affecting the successful performance of small and medium-sized enterprises are: a state, business environment, financial institutions, society, foreign states, higher educational establishments (research institutions). We attempted in this study to find out and consider those factors from the position of such an impact subject as a state and in particular through one of its spheres of influence to be the tax legislation.

The taxes, tax burden as the external factors that influence successful business activities of any enterprise (small, medium or large-scale one) were studied in the papers of many domestic and foreign scholars. The tax burden evaluation was given in 2015 by V.L. Kurochkin (2014) and A. Filimonov (2015).

The tax burden impact on corporations' economic growth as an external institutional factor was reported in the paper of D.S. Bents, I.A. Belova, E.S. Silova (2014). The study of the tax burden as an external institutional factor of the medium-scale enterprises successfulness was given in the paper of I.A. Belova, E.V. Nikolaeva (2014).

The foreign authors who study the tax legislation influence on small and medium-scale businesses are A. Hansford, J. Hasseldine J. (2012), C. Crawford, J. Freedman (2010), F. Chittenden et al (1999), C. Evans et al (2001), S. Kauser et al (2001), S. Smulders (2012). They believe that compliance with the tax legislation is the external factor of small and medium-sized enterprises' costs increase. In addition, they assert that the regular requirements for businesses, especially small and medium-sized enterprises, are onerous and can impede their growth and success. Taxation of small

and medium-sized businesses as an external factor of the institutional environment was examined by I. Tochitskaya, A. Glambotskaya, E. Rakova (2008).

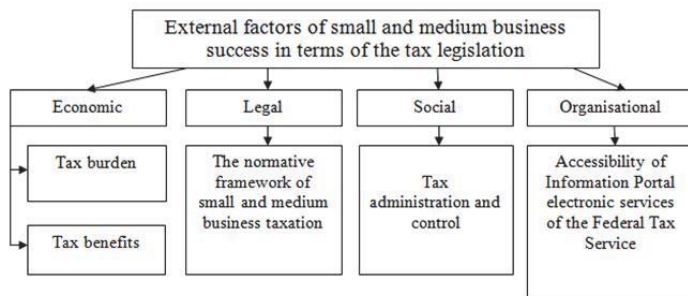
## 2. Methodology and Data

The analytical and review articles on small and medium business taxation, the study of success of small and medium-sized businesses in the current economic conditions made up the theoretical and methodological basis of this research. The information basis of this research rests upon the legislative acts of the Russian Federation. The macroeconomic statistics data of the Ministry of Finance of the RF, Federal portal for small and medium-sized enterprises of the Ministry of Economic Development of the RF, Federal Tax Service, Agency for Strategic Initiatives of the RF were also used in the study.

To process the data, general scientific methods of research such as comparative analysis, graphical analysis, synthesis, grouping and generalisation were used.

## 3. Results

There are several aspects influencing small and medium business successfulness in the current tax legislation as an external factor. The classification of the external factors of small and medium business success in terms of the tax legislation is given in Figure 1.



**Figure 1.** Classification of the external factors of small and medium-scale business success in terms of the tax legislation.

All the selected external factors are important for the study of success problems of small and medium-sized businesses. We focus in this paper on the economic factors as the most important impeding or stimulating force making an impact on small and medium-scale business. The study of other external factors of successfulness in terms of the tax legislation will be done in our further researches.

### 3.1 Small and Medium-scale Business Tax Burden

Analyzing the efficiency of the controlling activities performed by the regional governmental bodies allows us to assess the total efficiency of the controlling activities performed by governmental bodies in general. The main quantitative parameter characterizing the work of governmental bodies is normally the amount of the payments additionally charged as resulting from the controlling activity and its dynamics as compared to the previous periods. Resulting from the controlling activities performed by the taxation authorities, the following amounts, including taxes, fines and penalties, were additionally charged in the corresponding reported periods: 1,004.5 million rubles in 2012, 881 million rubles in 2013, and 806.9 million rubles in 2014. Thus, we see the total amount of the payments additionally charged going down within the period of the observation. In 2013 the extra charges reduced by 12.3% if compared to 2012, and it went down by 8.4% in 2014. In 2012, the specific share of the payments additionally charged as resulting from the audits in the total amount of the payments additional charged was 2.3% and 97.7% as resulting from the tax audits; in 2013 it was 9.7% and 90.3% correspondingly; and 3.3% and 96.7% in 2014. The major source of the payments additionally charged is making field tax audits. These data show that the specific share of all the payments additionally charged as resulting from the controlling activities performed by the Department in the total amount of the payments recovered to the budget is

going down within the period of the analysis. So, it was 13.74% in 2012, 9.92% in 2013, and 9.67% in 2014. The reduction of the value is mainly caused by the growth of the total amount of the payments recovered to the budget, while the charges resulting from the controlling activities are decreasing. When assessing the results of the work, we should take account of the fact that the amount of the taxes additionally charged often differs from the amount that reaches the budget then. As a rule, only 40% to 50% of the taxes and duties additionally charged as resulting from all kinds of tax audits (field and office audits) are actually recovered to the budget (Murzina, Larionova, Yalyalieva, 2015).

While analyzing the tax policy for 2015 and 2016 and 2017 years under planning it should be noted that one of the basic principles to be zero tax burden increase is not observed. There are no provisions to stimulate the development and problem solving of small and medium-sized businesses. Every year appear stobringasurprisal. This concerns social insurance charges increase, dramatic shifts in the application of the simplified tax regimes. Currently, the real level of tax burden on small and medium-scale business is much higher than the data of the official statistics show. This discrepancy can be explained by the application of different tax burden techniques calculation. The tax burden is the main indicator showing the share of the revenues paid by the company to the state. To calculate the tax burden it is necessary to correlate the amount of taxes paid with the sales, work and services revenues. Tax authorities employees, based on paragraph 1 of the public criteria, approved by Order of the Federal Tax Service of Russia of May 30, 2007 No. MM-Z-06 / 333 @) (2007) calculate the tax burden as correlation of the sum of all taxes paid during the year to the yearly revenue (excluding VAT) using the accounting records. Thus, they recommend using the revenue data according to the Russia's statistics, that is, excluding value added tax (VAT). This is due to the fact that in the financial statements submitted to the statistical bodies, the revenues are shown without VAT. To calculate the amount of taxes paid, non-budgetary funds payments (insurance payments) and the personal income taxes (PIT) are to be excluded. Such an approach is applied because the non-budgetary funds payments are not taxes by virtue of Chapter 2 of the RF Tax Code. A personal income tax is the liability of the business' employees, not the enterprise. Thus, taking into account all said above, the tax burden according to the official statistics will be lower than the real one. Although non-budgetary funds payments are not taxes they increase the fiscal burden for any small and medium-sized enterprise.

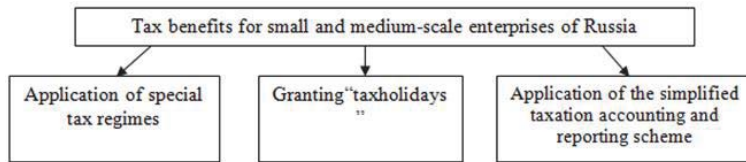
Until the law on "tax holidays" and the decision on preserving tax conditions for 2015-2018 were adopted, the government managed somehow to increase small and medium-scale business tax burden by means of the following:

Firstly, they introduced the obligation to pay the property tax calculated on the basis of the property cadastral value for small and medium-sized enterprises using the simplified taxation scheme (STS) and the taxation scheme in the form of a unified tax on imputed income for particular type of activity (UTPA). Until then such businesses were exempt from paying the property tax. New regulations for small and medium-sized enterprises using STS came into force from January 1, 2015 and UTPA were of effect since the third quarter of 2014. In these conditions, such property of small and medium-sized enterprises as shopping malls and premises in them, non-residential premises used for offices, commercial facilities, catering, domestic services come into the view. The positive point is that, as before, the RF subjects are free to set the business property tax rates on property of organizations, the procedure and terms of tax payment, tax benefits, and particulars of the tax base.

Secondly, in the cities of federal significance (Moscow, Saint Petersburg, Sevastopol) a local sales levy for small commercial enterprises and individual entrepreneurs was introduced. It is applied to a stationary retail chain, both not possessing selling areas (excluding filling stations) and having ones, selling through non-stationary and stationary outlets and through selling from stock. The tax will be imposed on small retail businesses and sole proprietors who do not use patent system of taxation. Small and medium-sized enterprises using a patent taxation scheme (PTS) and a taxation scheme for agricultural producers (TSAP) will be exempt from this tax payment. Small and medium-sized enterprises using the simplified taxation scheme can reduce PIT in the amount of the sales tax, profit tax or a unified tax paid within the simplified taxation system. The tax rates are set by the subjects of the Russian Federation for the quarter based on the selling area or its square. At the same time the rates will be limited by the calculated value of the patent for the particular activity, issued for the period of three months. This circumstance is not a significant factor impeding the tax burden increase, as the cost of the patent is also set by the regions and can reach 60 thousand rubles for retail premises.

To sum up, we can say that the government's policy what regards tax regulation is non-systemic. As a rule, decisions taken often contradict each other and sometimes they come to naught. Besides, some decisions taken lose their force within two or three years. However, along with this, there are some positive trends in supporting small and medium-sized businesses. These are trends relating to mainly tax benefits and preferences for the companies under study (improvement of the special tax regimes, introduction of the "tax holidays", easing tax accounting and reporting).

Tax benefits for small and medium-scale business. Tax benefits aimed at supporting small and medium-sized businesses include several aspects. The classification of tax benefits for small and medium-sized enterprises is given in Figure 2.



**Figure 2.** Classification of tax benefits for small and medium-sized enterprises of Russia.

Further on we will take a closer look at each type of tax benefits granted to small and medium-sized businesses in the current economic conditions.

### 3.2 Practice of specific tax regimes

Under the current tax legislation in order to promote and support small and medium-sized business five special tax regimes are envisaged: a simplified tax scheme (STS); a unified tax on imputed income for particular type of activity (UTPA); a patent taxation scheme (PTS); and a taxation scheme for agricultural producers (a unified agricultural tax), taxation scheme for production sharing agreements. The first three schemes said above respectively are in higher demand with the small and medium-sized businesses. The advantage for small and medium-sized enterprises using these tax regimes is that these businesses have a lower tax burden compared to those applying the general tax regime since the business under a preferential tax regime are exempt from some taxes being a corporate income tax, property tax and value added tax (excluding import of goods into the customs territory of Russia). Instead, small and medium-sized businesses pay one lower tax. For instance, a business under the simplified tax scheme pays 6% tax if the income is a taxation object, 15% tax is paid if revenues reduced by the amount of expenditure are a taxation object. For this purpose differentiation of tax rates from 5 to 15% depending on the taxpayer type is stipulated by the laws of the Russian Federation subjects. In respect of the small and medium-sized enterprises working in the Republic of Crimea, in Sevastopol and using a simplified taxation scheme in 2015-2016 the tax rate can be reduced to 0%. For the period of 2017-2021, the tax rate can be reduced to 4% (income being the object of taxation), up to 10% (income reduced by the amount of expenses being the object of taxation). A simplified taxation scheme can be applied by the small and medium-sized enterprises whose activities are in the sphere of material production (construction, transportation, communications, processing industries) and in trade.

Such a tax regime as UTPA is more intended for small and medium-scale businesses in retailing and in provision of services to the population. The size of the UTPA tax is calculated by the established formula. The calculation of the amount of the tax is based on the enterprise reference profitability established by the subjects of the Russian Federation. The tax calculation formula also includes special coefficients of the specific company activities.

The enterprises mentioned above shift to those regimes at their own free will. However, not all small and medium-scale businesses can use the preferential tax regimes. There are restraints connected with the company activities, size and economic indicators.

Quite recently - on January 01, 2013 - a new special tax regime was introduced which is a patent taxation scheme (PTS). The patent covers 47 activities carried out in the provision of public services and retailing. The subject of the Russian Federation independently sets for each activity type the size of possible income to be the tax base within the minimum (100 thousand rubles) and maximum size (1 million rubles). The cost of the patent varies mainly 6 - 60 thousand rubles per year.

The feature of the above described tax regimes is that in addition to the taxes provided for by the tax regime, the enterprises pay into non-budgetary funds and personal income tax (PIT) for their employees.

It should be noted that in order to support small and medium-sized businesses in 2015-2016 in the field of taxation some measures were introduced (Order of the Government of the Russian Federation on January 27, 2015). These measures concern special tax regimes improvement for small and medium-sized enterprises. By the RF subjects' decision for enterprises on the simplified tax system the size of the tax is reduced from 6% to 1% (when income is the object of taxation). By the RF subjects' decision for taxpayers using the UTPA scheme, the tax rates are reduced from 15% to 7.5%. By the RF subjects' decision for enterprises using the patent taxation scheme, the list of activities is expanded and the maximum size of the income is 2 times reduced (from 1 m to 500 thousand rubles).

Tax benefits cover the patent for self-employed citizens (the individuals working without salaried employees and having a patent for one type of business for which the PTS can be applied). A special algorithm of PIT and state non-

budgetary funds payments is applied for the self-employed citizens' patents. Within the patent scheme the said taxes and PTS tax paid by the self-employed citizens when being registered can be paid simultaneously by one stop principle.

Tax incentives for small and medium-scale businesses envisage a two-times increase of the maximum size of the annual revenues received from selling goods, works and services. The maximum values of the annual revenues for small and medium-sized businesses are given in Table 1.

**Table 1.** Maximum values of the annual revenues for small and medium-sized businesses

Type of Enterprise	Previous Value of the Maximum Revenues	Current Value of the Maximum Revenues
Microenterprises	60 m rubles	120 m rubles
Small-scale enterprises	400 m rubles	800 m rubles
Medium-scale enterprises	1 b rubles	2 b rubles

### 3.3 "Tax holidays" granting

Tax holidays are exemption of taxpayers (companies and entrepreneurs) from one or several taxes during a certain period of time. Tax holidays are introduced in accordance with the relevant regulations in order to promote the development of certain branches of economy. In order to support small and medium-sized businesses in Russia in the current economic conditions, on January 1, 2015 Federal Law of December 29, 2014 No. 477-FZ On Amendments to Part Two of the Tax Code of the Russian Federation came into force (2014). This law includes the following main points:

- 1) To delegate the power to the subjects of the Russian Federation to grant tax holidays for the period of 2 years for the first time registered small and medium sized enterprises as sole proprietors. In such a case the sole proprietors are to switch to the simplified tax scheme (STS) or the patent taxation system (PTS) within 2 years from the date of registration.
- 2) Tax holidays are applied to the individual entrepreneurs operating in production, research and social spheres. Forms of business activity in these spheres are defined by the subjects of the Russian Federation in accordance with the National Classification of public services. The subjects of the Russian Federation may provide tax holidays during the period of 2015-2020.
- 3) The subjects of the Russian Federation according to the laws have the right to set restrictions for small and medium-scale businesses on tax holidays. These restrictions are applied to the average number of employees and the maximum value of revenues from selling goods, works and services. Violation of the restrictions is the basis for forfeiture of the right to apply the tax benefit incentives in the form of tax holidays.

### 3.4 The simplified system of tax statement and report

Small and medium-sized businesses as business entities shall regularly pay taxes and effect non-budgetary funds payments, submit the appropriate reports. The list of accountable receipts and the amount of tax and non-budget funds payments depend on the tax regime selected, type of activity, presence or absence of employees.

Small and medium-sized enterprises using certain tax regimes execute a minimum accounting and submit the minimum types of reports. If a small-scale business is registered as a sole proprietor and has no employees, it is exempt from the duties of a tax agent. Submission of reports to the non-budgetary funds since 2015 by the individual entrepreneurs having no employees is not obligatory. A tax statement for enterprises using the STS or UTPA includes only completing one tax return of the approved form for the year. If the entrepreneur has salaried employees then by the end of the year tax returns of 2-PIT Form are to be submitted on all individuals who were paid money and an income tax on individuals was withheld. All small and medium-sized enterprises regardless of the tax regime shall submit information to the tax authorities on the average number of employees as well as reports to non-budgetary funds (The Pension Fund of the Russian Federation, the Social Insurance Fund of the Russian Federation).

## 4. Conclusions

The results of this study performed allow us to draw the following conclusions. Firstly, as external success factors of small and medium-scale business in the view of the tax legislation we were able to identify 4 groups of factors which fully characterize the external environment: economic, legal, social and organizational. The emphasis was done on the economic factors. Other factors are seen to be the basis for further research. Secondly, the influence of economic factors

on the success of small and medium-scale business is examined through the study of the tax burden and existing tax benefits and preferences for small and medium-sized businesses in the current economic situation. Thirdly, decisions taken to support small and medium-sized businesses within the taxation system are controversial. On the one hand, new tax benefits (tax holidays) have been introduced, on the other hand, the new types of taxes (sales taxes) have been put into effect. The former are aimed at easing the tax burden, and the latter, on the contrary, increase it. Fourthly, the positive thing is expanding tax benefits, namely, improvement of the certain tax regimes, introducing tax holidays, improvement and simplification of tax statements and reports for small and medium-sized businesses.

## 5. Acknowledgement

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