

Taxation of SMEs, Growth and Employment



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Taxation of SMEs, growth and employment

- About SMEs: diversity and heterogeneity
- Taxation and entrepreneurship: do taxes matter? Which type of taxes are relevant ?
- Tax incentives for SMEs: do we need them? How should they be designed ?



About SMEs....

■ Heterogeneity

- OECD Countries
- Transition economies:
 - Large informal sector
 - Self-employment contributes to poverty reduction

■ Stylised facts

- Numerical importance > economic importance
- But they vote... (political economy issue)
- Most of the SMEs do not grow
- How can the government «pick the winners»?



Taxation and entrepreneurship

(a) Theoretical predictions

- An individual may decide to become an entrepreneur if the expected **net** wage is lower than the net expected average of income from business over time, taking into account the effect of risk on utility and well being
- Self-employment involves uncertainty
- Entrepreneurial income may be taxed differently
- Self-employment can provide tax sheltering opportunities (or facilitate tax evasion)



Taxation and entrepreneurship

(b) Issues far tax policy

- Taxation of employment / self-employment
- Taxation and organisation form (incorporate or not?)
- Adverse effect of progressivity on risk-taking
- Tax sheltering advantages
- Taxes to be considered
 - PIT
 - Capital gains tax
 - Social security contributions if they are not neutral from an actuarial point of view



Taxation on entrepreneurship

(c) Empirical evidence

- Cross country evidence (DE MOOIJ and NICODEME, 2007)
 - PIT and CIT have an adverse effect (-0.248 for the PIT rate)
 - Adverse effect PIT larger than for CIT
 - Progressivity has an adverse effect
 - Tax difference (PIT-CIT) has an effect on incorporation (semi elasticity 1.6)
- Country evidence: mixed results



Tax incentive for SMEs

(a) Is there a case for tax incentives ?

- Developing countries – Transition economies
- OECD countries - “Mature” economies



Tax incentive for SMEs

(a) Is there a case for tax incentives ?

- Developing countries – Transition economies
 - Positive externalities arising from poverty reduction
 - Income of the target group < Income tax threshold
 - Financing constraints: a case for public support to microfinance?



Tax incentive for SMEs

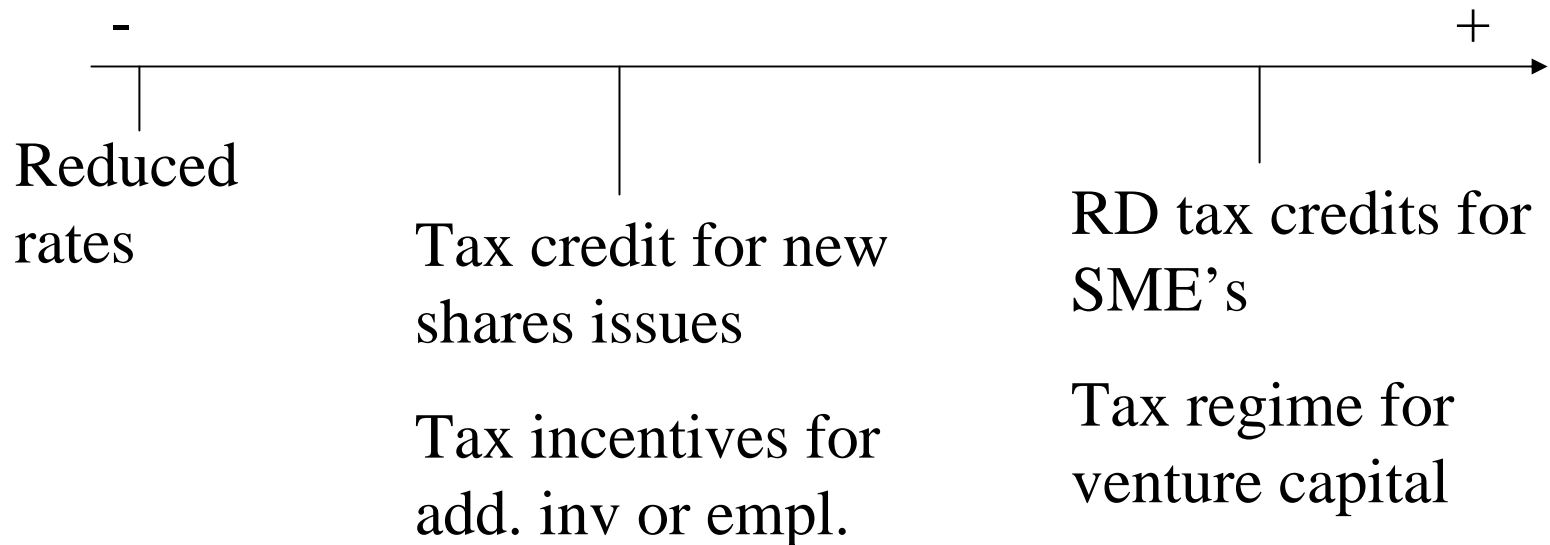
(a) Is there a case for tax incentives ?

- Income redistribution ?
- Small is beautiful ?
- Market imperfections ?
(Financing)
- Compliance cost issue?
- Externalities (Growth,
employment creation):
- Strong political pressure
- *Does not require
reduced rate for SME's*
- *Efficiency requires a
neutral tax system*
- *Might be voluntary*
- *General issues of fixed
costs*
- *Many were called, few
were choosen....*
- *Indeed...*

Tax incentive for SMEs

(a) Is there a case for tax incentive ?

■ How could we « pick the winners » ?





Tax incentive for SMEs

(b) Cases studies

■ Reduced rates

- France
- Belgium

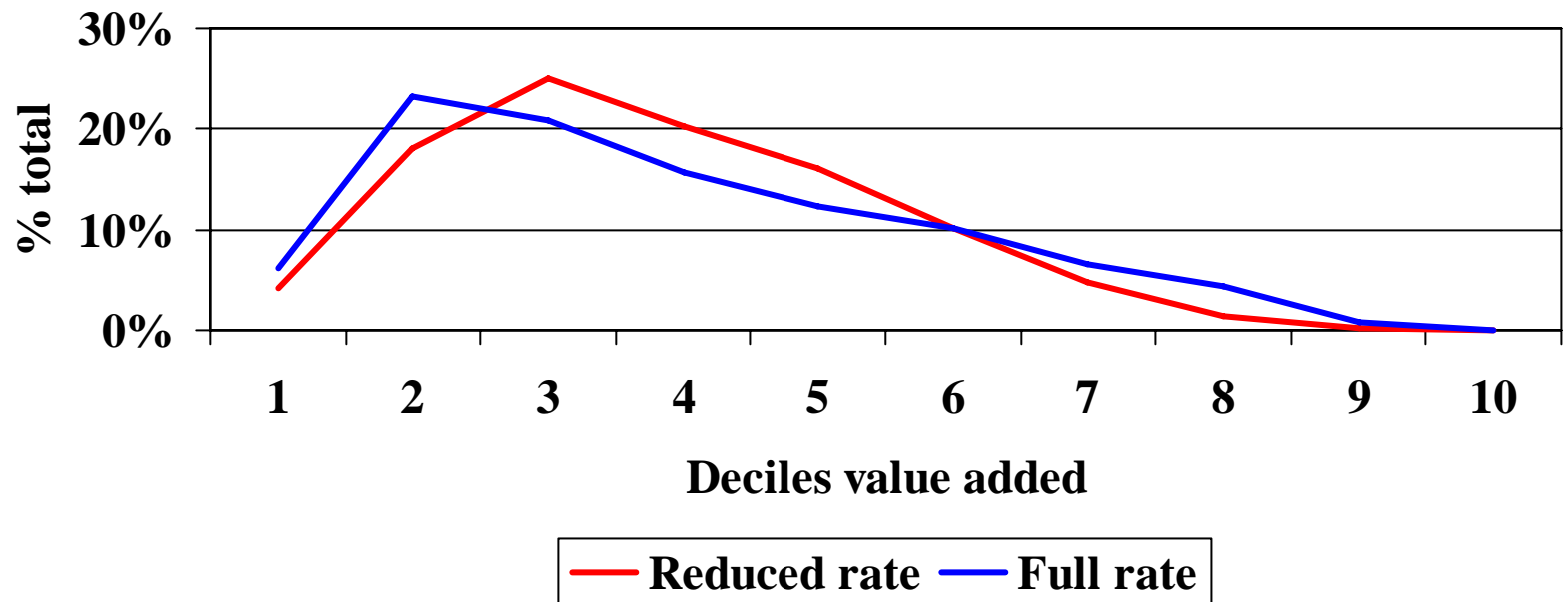
■ Financing constraints ?

- France
- Belgium

Tax incentive for SMEs

(b) Cases studies: Reduced rates

Distribution of small companies (according to the corporation code) - Belgium





Tax incentive for SMEs

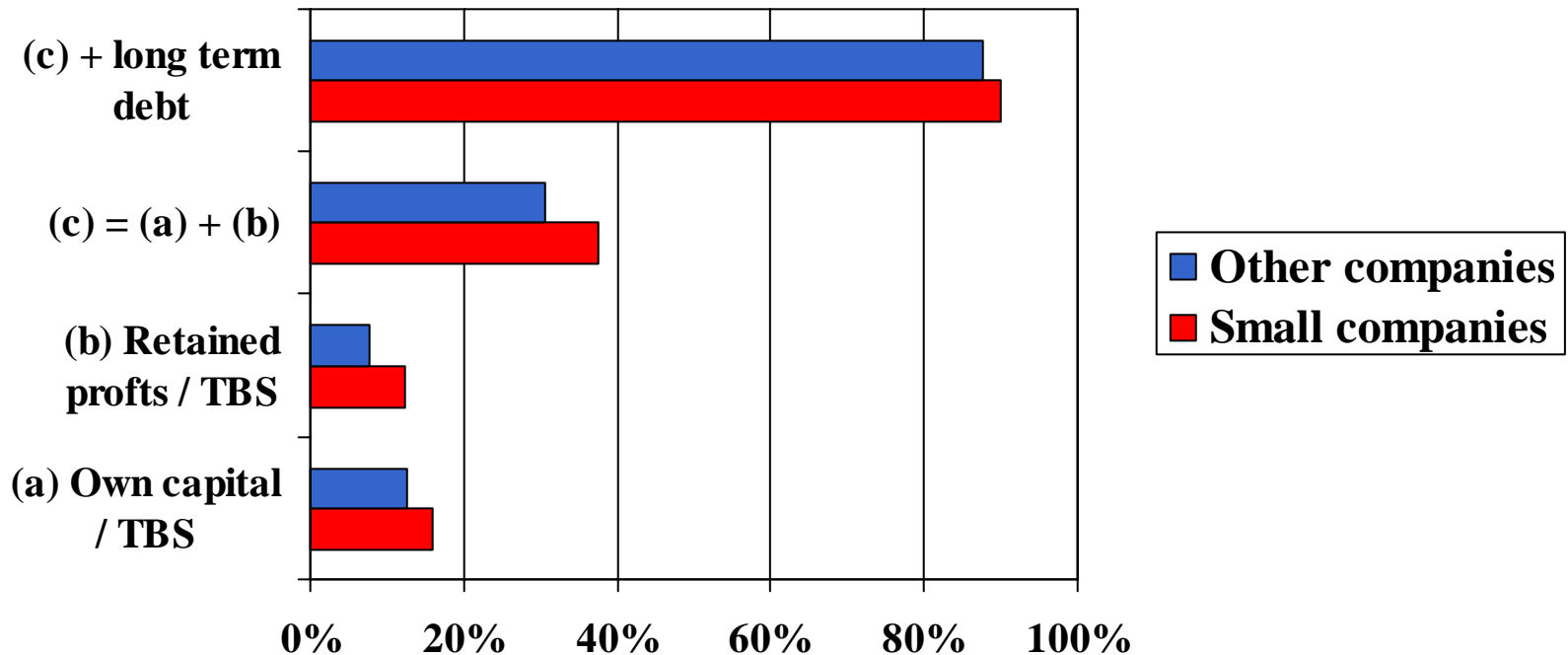
(b) Cases studies: Reduced rates - France

- Reduced rate: 15% on profits < 38.120€ (full rate= 33,33%)
- 90% of the companies qualify, but they account only for 13 of total employment
- 33% of the companies enjoy a tax rebate of 50%
- Not targeted to young companies

Tax incentive for SMEs

(b) Cases studies: Financing

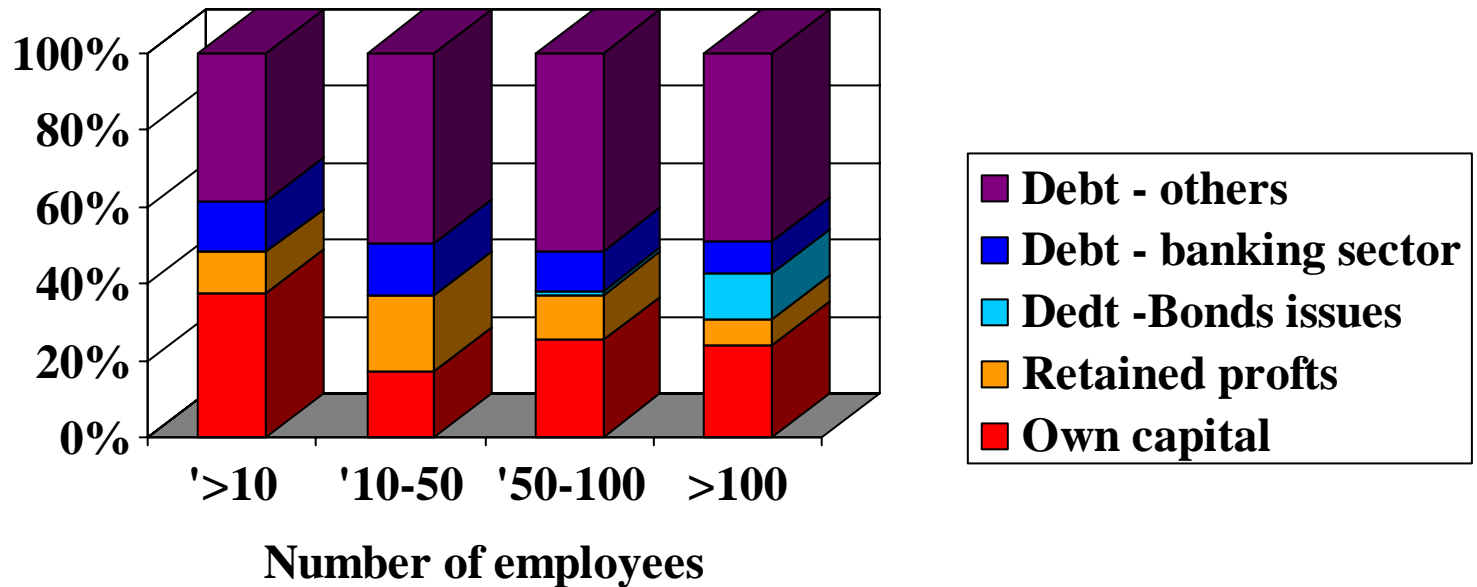
Financing: an issue ? The case of Belgium



Tax incentive for SMEs

(b) Cases studies: Financing

Own capital, retained profits and debt France - 2004





Concluding comments...and questions

■ ***Developing economies:***

- There is a (strong?) case for preferential treatment micro-entreprises, based on poverty alleviation, but tax policy might be irrelevant (apart for promoting microfinance ?)

■ ***OECD countries***

- Do taxes matter ? Mixed evidence...
- Is there a case for tax incentives?
 - Most of the arguments are not fully convincing
 - apart from positive externalities in poverty reduction for developing countries
- How to pick the winners ?
- Non-targeted incentives might be a waste of resources....
- ...apart from a political economy perspective