

ITD International Conference on SMEs Taxation Plenary Session III

Inter-American Tax Administration Center CIAT

**“Diverse policy and tax administration challenges
faced by micro, small and medium size enterprises”**

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SME Concept and segmentation criteria

- **There is not a univocal concept:** varies between regions, countries and within the country itself, according to the institution and purpose
- **A diversity of attributes are required to define and segment SMEs:**
 - **Quantitative Criteria:** among the most common: number of employees, business volume and volume of assets. The type of activity is sometimes differentiated
 - **Qualitative Criteria:** Owner works and participates in management, assets ownership, access to financing and legal constitution
- **Geographical Location:** necessary to establish setting in order to define and segment it.

SME characteristics and segmentation

MICRO-ENTERPRISES

organized within the formal sector or as a survival means in response to unemployment

low productivity and capitalization
very small contracted labor force; owners and the family are the employees

vicious circle (low income and low reinvestment capacity) may produce a quick extinction

conditions must be created by the State (including tributary conditions) that allow the insertion into the economy, thus benefiting productive and social structure.

SMALL ENTERPRISES

initiative to take risks and willingness to grow

limitations in regard to self-owned capital
availability or access to outside funding

consider market opportunities, available resources and management capacity

important joint participation capacity within the economy and in employment generation

simple organization structure that facilitates agile and innovative management

fast adaptation to new demands; offer of customized products and services

MEDIUM-SIZE ENTERPRISES

are the result of a growing initiative that is willing to grow from the beginning

differentiated by the quantity of factors utilized and the operational focus in regard to the range of products and the geographical area that cover

participation of owners in the direction and management with professional support

good level of organization, long-range planning and access to financial market, although restricted to short-term credit

low assignment of resources for training, research and new product development

Contribution to economic development

- Create employment opportunities:
 - core role in the creation of job opportunities and reduction of poverty
 - of interest to economies under development with abundant labor force but short of capital;
- *source of economic development and innovation,*
 - Promote business entrepreneurship and competitiveness in exports;
- *intensify competitiveness, which is reflected in enhanced economic dynamics;*
- Contribute to an equitable distribution of income
 - offer employment opportunities, specially to the more impoverished people;
 - geographically more dispersed than major enterprises, contributing to reduce disparity among geographical areas.

Setbacks for their creation and growth

- Lack of access to funding, or high interest rates are imposed as well as excessive collateral warranties;
- complex bureaucratic paperwork, with high rates of discretionary decisions and corruption;
- instability of taxation rules, evasion, complexity and high rate of compliance costs;
- deficient and uncoordinated public and private support systems.

Possible corrective measures (other than taxation)

- Implementation of suitable funding mechanisms;
- more efficient public administration agencies;
- taxation policy is a suitable instrument to leverage achievement of extra-fiscal objectives, although not all the objectives are adequate to be implemented by taxation instances;
- a range of tributary measures exist but there is a shortage of information on its cost and effectiveness.

¿Is the tributary treatment an important factor in this matter?

- the problems derived from taxation are not different from those to which any type of business might be subject;
- Income tax may affect levels of investment and accumulation of capital, social charges may rise cost of labor, VAT may inadequately contract the demand, specially with high proportional payments;
- these effects may become magnified to SMEs due to their characteristics. With difficult funding, internal formation of capital becomes an issue; through intensive use of labor, its cost affects competitiveness; with low productivity, high VAT difficult complete transactions.

Should special tributary regimes be established for SMEs?

- tax legislation usually compares the SME concept with small-size contributors framed within the parameters established for them;
- they should be reserved for enterprises whose organization and operations volume justify the exclusion from the general regime;
- They usually are voluntary in nature and three types of regime may be distinguished:
 - *Substitutive integral*, that establishes a fee that substitutes several tributes ;
 - *with exceptions in the general regime of several taxes*;
 - *With exceptions in the general regime of a certain type of tax.*

What would be the impact on the attributes of a good tributary system?

- **fairness**, could mean more attention to the contributing capacity (vertical fairness); however, it is necessary that contributors under the same circumstances receive an equivalent treatment (horizontal fairness);
- **neutrality**, may promote disaggregation and self-limitation of productive units to stay within the parameters that allow the benefits of the regime;
- **stability**, if SMEs generate employment and can adapt themselves to change, their promotion enhances the stabilization function and growth;
- **simplification**, facilitates knowledge of obligations by participating enterprises, but also means more complexity in regard to the overall tributary system;
- **costs** under control by the administration may be reduced as well as compliance by contributors.

Simplification and effective costs reduction

- simplification of standards to determine tributes and formal obligations
- also originates when considering Tax Administration (TA) limitations
- reduced costs of staying within the formal system and costs and complexity of TA control by facilitating the use of massive systematic processes and providing more resources to the control of larger contributors.
- necessity to be cautious when simplifying data and the required records, in order to keep control on straightforwardness and permanence within the regime and to favor a “fictitious formality”

Services and support to SMEs in their role as contributors

- general strategy to promote spontaneous compliance, balance between service actions and control
- general assistance services to contributors empowered by the Internet
- facilitated connection with small contributors network
- support through training and an array of products that facilitate compliance, specially in regard to requirements of registration and documentation of operations, although they are minimum for the micro-enterprise.

Conclusions

- Multiplicity of definitions for SMEs, proposals for their tax compliance, and environment, require a high degree of generation of possible conclusions and recommendations
- Many of the setbacks for their creation and development are not related to tributary matters
- The problems derived from tax payment are not very different from other problems in any type of enterprise, but may be magnified for SMEs given their characteristics
- Tributary legislation typically establishes regimes for small contributors framed within the parameters that they propose.
- In the overall promotion of SMEs, alternative non-tributary instruments may be used, saving the tributary instruments to micro enterprises, as the trend seems to be.
- Major objectives in LA are simplification and cost reduction to encourage SMEs to incorporate to formal economy, thus facilitating their control. The most adequate solution to achieve this could be the substitutive integral regimes, where fairness would also play an important role.
- Regarding simplification of formal requirements, it is necessary to consider that studies on tax evasion point out that the degree of such evasion increases as the size of the enterprise decreases.
- Tax administration should offer effective support to small enterprises to keep records of their business.