

TAXATION OF SMALL AND MEDIUM
ENTERPRISES

by

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Abstract

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Small and medium enterprises (SME) play an important role in production sector of many developed countries. The higher is the share of small and medium businesses in the economy, the higher productivity can be potentially realized with the SME sector. Development of small and medium enterprises is heavily influenced by the level of taxation, its administration and compliance. Therefore, maintaining the ideal balance between tax rate, compliance costs, tax administration and economic development should be a main goal of every tax policy. In this paper, the impact of two current policies in Ukraine on SME taxation is analyzed: introduction of a fixed (lump-sum) tax intended to reduce welfare losses through «bringing entrepreneurs out of the shadow»; and imposing of a single tax which was supposed to simplify the accounting system and reduce compliance costs.

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Chapter 1

INTRODUCTION

Economic growth in every country is defined by the performance of its production sector. In many highly developed countries a great share of production is manufactured by small and medium enterprises (SMEs) – an important part of their market economies. For instance, the portion of SMEs in GDP of Great Britain is 50-53%; of Germany – 50-54%, of USA – 52-55%; of Italy – 57-60%; of France – 63-67% (Small Business in Ukraine 1997 47). Consequently, up to 50-60 per cent of government revenues depends on the SME sector (Small Business in Ukraine 1997 41). Thus, the higher is the share of small and medium businesses in an economy, the higher the productivity that can be potentially realized with the SME sector.

The development of small and medium enterprises is greatly affected by the level of taxation, its administration and compliance: the higher the tax rate is, or the greater the efforts to fulfill taxation requirements are, as well as to check how those requirements are met, the lower the initiatives are for SMEs to perform well. Therefore, maintaining the tricky balance between tax rate, compliance costs, tax administrating and economic development should be a main goal of every tax policy.

In Ukraine, the SME sector has only started developing – the first Law of Ukraine «On Entrepreneurship» was adopted in February, 1991. Lack of proper incentives as well as unfavorable government policy towards small and medium enterprises has had a negative impact on the Ukrainian economy. Weak legislative support, administrative barriers, lack of financial assistance and uncertainty of an often

changed taxation system in particular force the main part of SMEs to operate in «shadow». According to expert evaluations, between 50 and 80 % of Ukraine's economy is in the extra legal sector. (Barriers to the Development of Small and Medium Business in Ukraine 1998 7). In order to create more favorable conditions for the SMEs, the following main priorities in state policy of Ukraine for small and medium enterprises have been underlined:

?? creation of a network of support and development of the sector;

?? promotion of a simplified system of taxation and accounting;

?? support of the proper training of people engaged in SMEs;

?? provision of financial support of small and medium enterprises (Enactment of the President of Ukraine «On State Support of Small Entrepreneurship» 1998).

As just seen, proper taxation policy for small and medium enterprises has become better appreciated. A correct level of taxation as well as clarity of taxation requirements will lead to higher development of the sector that in its turn will cause an increase in the degree of competitiveness of the economy, a rise in production and more stable government revenues.

However, Ukraine started creating its taxation policy with a mix of elements of different tax systems. Ukraine did not have an overall conception or integrated view of what its taxation should be. The situation was worsened by the fact that Ukraine did not have the institutions, laws or experience to jump to the sophisticated tax systems found in modern market economies. Therefore, Ukraine, as any transition economy, needs to consider tax regimes that generate revenue without inducing severe problems of evasion and compliance and enforcement costs while not acting to deter the rise of enterprises. However, as a transition

economy moves from transition to a more mature market economy, it could be expected that the tax regimes would mature as well.

In this work, Chapter 2 will define small and medium enterprises, describe their functions and the evaluate importance of the SME sector in economies in transition as well as discuss the impact of taxation system on small and medium enterprises development. Chapter 3 examines the costs of taxation according to welfare and optimal taxation theory and discuss how this analysis can be applied to Ukraine. Chapter 4 will examine current changes in Ukrainian tax legislation and analyze their effect on small and medium enterprises as well as on the economy in whole. Chapter 5 will be devoted to the proposals for development of SMEs taxation that is being discussed now. In Conclusions, recommendations for further development of Ukrainian taxation system will be presented

Chapter 2

SMALL AND MEDIUM ENTERPRISES AND THEIR ROLE IN TRANSITIONAL ECONOMIES. INFLUENCE OF TAXATION IN DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES SECTOR.

2.1. Definition of small and medium enterprises, their functions and role in economies in transition

A small and medium enterprise (SME) is defined in the European Union as a firm, the number of employees in which does not exceed 250 people; which has an annual value of sales that does not exceed 7 mln ECU (small enterprise), or 40 mln ECU (medium enterprise) and that fulfills the criterion of independence, i.e. a big part (at least 25%) of the capital of the firm does not belong to an enterprise that is not small or medium. (Recommendations of European Union #96/280/EU 1996).

However, due to special features of an economy in transition, in Enactment of President of Ukraine «On State Support of Small Entrepreneurship» #456/98, SMEs were defined differently: «Subjects of small and medium entrepreneurship are registered physical entities that are engaged in entrepreneurial activity without creating a legal entity as well as subjects of entrepreneurship of any organizational and legal form where the number of employees does not exceed 50 people and value of sales does not exceed 1,000,000 UAH per year» (Enactment of President of Ukraine «On State Support of Small Entrepreneurship» #456/98 1998). In my work, when talking about SME sector in developed countries I will refer to the first definition. However, when I start describing the Ukrainian economy, the second definition of small and medium enterprises will be used.

Small and medium enterprises perform several important functions in every economy:

- ?? Small and medium businesses help form a competitive environment;
- ?? They are actively engaged in research and development, promoting fast implementation of new technical and commercial ideas;
- ?? The SME sector quickly reacts to market changes and, thus, provides necessary flexibility to the economy;
- ?? SMEs assist in decreasing unemployment through the creation of new working places.

(Small Business in Ukraine 1997 114).

The last two functions of small and medium enterprises are of especial importance in a transitional economy. As has been observed, every country in transition experienced inflation, a fall in production, growing unemployment and fast unexpected changes of economic environment (Small Business in Ukraine 1997 45). The social-productive and social-economic advantages of small and medium businesses (flexibility, adaptation, open entry/exit to the sector, etc.) can help an economy to overcome those problems. Consequently, the development of small and medium enterprises should become an important part of economic policy of every economy in transition.

Small and medium enterprises are also important because they can help reduce the severity of the principal/agent problem¹. As has been mentioned by several authors (Gandhi and Dubravko 1992 142), this problem, together with a high level of bureaucracy, is a distinctive feature of a big enterprise in a planned economy. To

the contrary, competitive environment and the striving to survive create good incentives for a small and medium enterprise to minimize bureaucratic elements, as well as to make well-weighted decisions, implement them quickly and closely monitor their fulfillment.

Thus, promoting the development of small and medium enterprises should receive proper attention while, at the same time, the authorities are engaged in implementing complementary stabilizing macroeconomic policy in transition economies. Due to the features specific to the sector, it may be possible to solve the problems that are peculiar to these economies.

2.2. Role of taxation policy in promoting SME sector development

There are many factors that can influence the development of small and medium enterprises in the economy. The most frequently mentioned among them are: state support of the sector, proper legislative support and mechanisms of its fulfillment, access to financial resources and investment incentives (Small Business to Ukraine 1997 122). However, one of the most important factors that promotes development and growth of small and medium enterprises is the taxation system.

Research made in different countries has shown that the countries where the level of tax rates, the costs of fulfilling taxation requirements as well as costs of auditing are high, the sector of small and medium enterprises is comparatively small. For instance, in Ukraine, where policy of SME sector taxation is considered to be too burdensome, the share of the sector in GDP is only 5.5% (Analytical report on State Committee for Entrepreneurship Development 1997). Moreover, for several

¹ An *agency relationship* consists of an agreement under which one party, the *principal*, engages another party, the *agent*, to perform some service on principal's behalf...There are the *agency problems* – after the contract is set, agents have incentives to take actions that increase their utility at the expense of the principals. For example, managers might shirk, take prerequisites, and choose

years the share of operating SMEs among registered ones was falling: in 1992 that index was 49.4%, in 1993 – 47.7%, in 1994 – 37.3% (Small Business in Ukraine 1997 49). On the other hand, in the Czech Republic, where taxation policy for small and medium enterprises is milder, while all the other policies supporting small and medium businesses are approximately similar, the share of this sector in official GDP is more than 50% (Materials of the Seminar «Development of Entrepreneurship» 1998²).

Of course, such a big difference in numbers cannot only be due to the different taxation policies. It is understandable, that the transition in the Czech Republic started earlier and before transition the SME sector was present to greater degree in Czech economy than in Ukraine. However, in the Czech Republic proper taxation incentives were created at the very beginning of transition period. Thus, we can see that taxation policies can play a big part in promotion the development of the SME sector.

2.3. Conclusions

Small and medium enterprises play an important role in transitional economies due to some of their special features: flexibility, quick adaptation, minimum bureaucracy; and special functions: creating of additional working places, active promotion of innovations, creating a competitive environment. Different policy incentives are able to influence the development and growth of the SME sector. However, creating a proper taxation policy can be one of the crucial factors in this process.

investment and operating policies that reduce profits but increase the manager's welfare (Brickley 1997 154)

² Special Seminar «Development of Entrepreneurship» for representatives of State Committee of Ukraine for Entrepreneurship Development organized by Ministry of Industry and Trade of Czech Republic, Prague, November, 1998

Chapter 3

TAXATION OF SMALL AND MEDIUM ENTERPRISES: BASIC THEORETICAL CONCEPTS

3.1. Theoretical taxation policy considerations

All the textbooks list three main features of a perfect taxation system: efficiency, equity and simplicity (Auerbach and Slemrod 1997 593). Efficiency is understood as economic neutrality: taxation imposes no interference with private decision-making. Equity means «equal treatment of equals» as well as distribution of tax liabilities according to the level of well-being. Simplicity is often used as a synonym for easy compliance and simple administrating.

One of the goals of taxation is to raise government revenue in order to cover public spending connected with eliminating market failures (e.g. externalities³, public goods⁴) and redistribution of income. The other important role of taxation is a corrective role (e.g. Pigovian tax⁵), the purpose of which is to achieve welfare gains rather than to minimize welfare losses (Kay 1990 39).

Despite these roles, taxation nevertheless imposes costs that must be taken into account when a specific taxation policy is considered. The main point emphasized by many economists is that there is a deadweight loss from taxation – the economic costs of taxes often exceeds the revenue collected by the government (Cullis and Jones 1998 159, Kay 1990 48). That loss can be eliminated by using

³ An external effect, or externality for short, is said to occur when the production or consumption decisions of one agent affect the utility of another agent in a unintended way, and when no compensation is made by the producer of the external effect to the affected party (e.g. pollution) (Perman, Ma and McGilvray 1996 95).

⁴ A public good is a commodity for which use of a unit of the good by one agent does not preclude its use by others (e.g. knowledge, national defense) (Mas-Colell, Whinston and Green 1995 359).

a lump-sum tax – one of the two non-distortionary tools (the other one is transfer) proposed by economic theory (Stern 1991 274). Lump-sum taxation is able to reduce excess tax burden because it does not affect the relative price rates, unlike an excise tax that distorts them⁶.

This result can be shown with the help of general equilibrium analysis tools. For simplicity of exposition, we use a static model of an economy with fixed factor supplies that produces only two private goods: X and Y. Let's also assume that the economy is open to international trade and relative prices are determined in the world markets. The production possibility frontier (PPF)⁷ of that economy is depicted on Figure 1. Assuming that markets are perfectly competitive and there are no externalities, then the Pareto optimal⁸ level of production will be at point 1: there slope of PPF line coincides with the slopes of community's indifference curve⁹ U1 and relative price line p1.

⁵ Pigovian taxation – an attempt to restore optimality by imposing a tax on the externality-generating activity. Optimality-restoring tax is exactly equal to the marginal externality at the optimal solution) (Mas-Colell, Whinston and Green 1995 355).

⁶ However, in some circumstances a lump-sum tax can be distortionary. For instance, if its sum depends on income, revenue or any other characteristic that the taxed entity can alter.

⁷ Production-possibility frontier is a set of maximum output pairs (x, y) that can be produced using the economy's available factor outputs (Mas-Colell, Whinston and Green 1995 533).

⁸ An economic outcome is said to be Pareto optimal if it is impossible to make some individuals better-off without making some other individuals worse-off (Mas-Colell, Whinston and Green 1995 307).

⁹ Community indifference curve – a level set of a social welfare function.

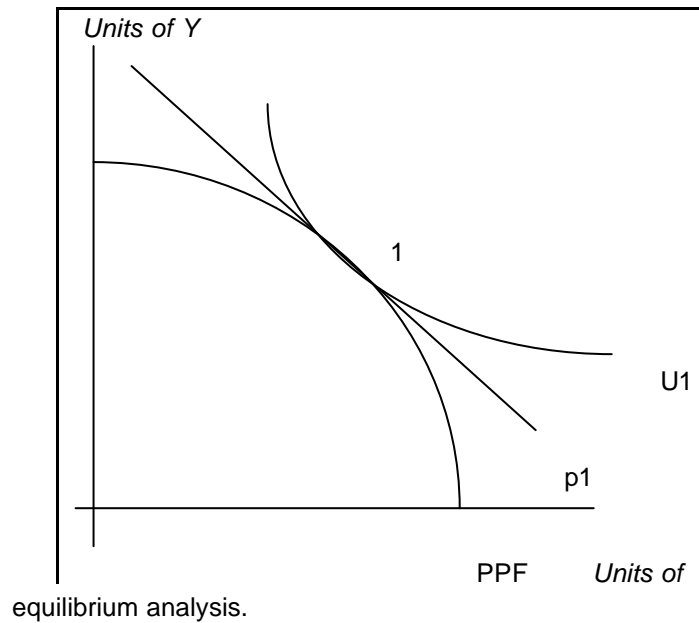


Figure 1. Pareto optimal allocation in an economy that produces goods X and Y: a general

equilibrium analysis.

Now let's put taxation into the model. We assume that resources for taxation are taken from the private sector, and government does not produce anything (e.g. taxation revenue gathered goes abroad to cover an external debt). Thus, the PPF curve has to change – the new production possibility frontier lies closer to the origin (PPF' on Figure 2). PPF' shows the available resources for private goods production after taxation. Suppose, that the tax imposed is a lump-sum tax. The new equilibrium point is 2. Relative prices are not changed: p_2 is parallel to p_1 . Then the slopes of indifference curve U_2 and PPF' at point 2 are still equal to those at point 1. Thus, the loss of welfare to the society is only due to a decrease of the resources in the economy.

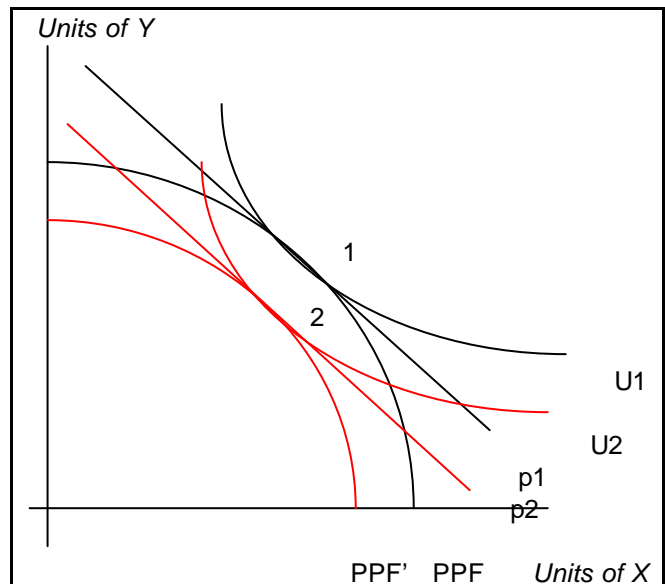


Figure 2. Effect of lump-sum tax.

Now suppose that the tax induced is an excise tax t on X . Relative prices that consumers face are $P_x(1+t)/P_y$. The slope of the new relative price line (the p_3 line on Figure 3) is steeper than that of the initial p_1 or p_2 lines. As consumers equate it with the slope of the indifference curve U_3 , then the new equilibrium is at point 3. However, at point 3 producers set prices equal to the slope of PPF' line; they are shown by the p_3' line.

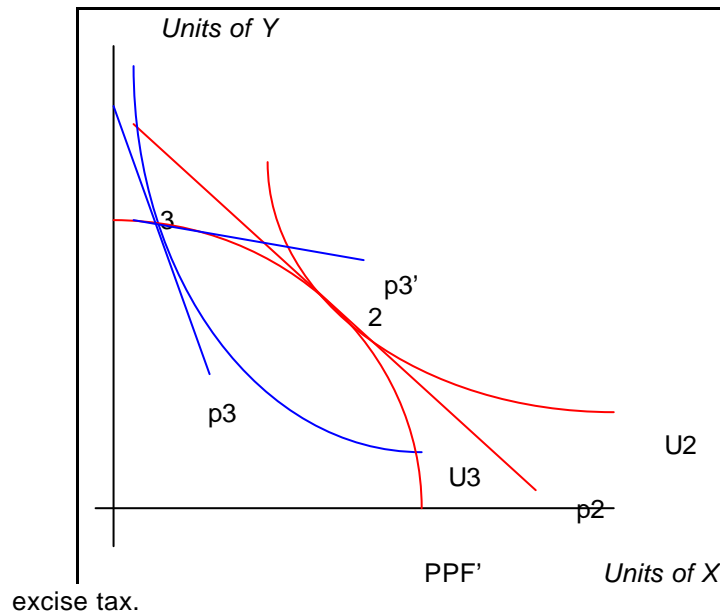


Figure 3. Effect of

As it is seen, at point 3 the community is not only at a lower level of utility compared with point 2 because the distortion between producers and consumers prices has increased the burden to the society. It is also not a Pareto optimal allocation of resources. Thus, lump-sum tax is preferable to society because it does not cause additional burdens due to inefficiency in resource allocation¹⁰.

From a policy perspective it is also important to say that welfare deadweight losses are not the only costs of taxation. Another loss is associated with administrative costs (connected with the efforts to administer taxes), compliance costs (borne by the taxpayers; these are costs of meeting the requirements of the tax system), lobbying (rent-seeking) costs (these are associated with the lobbying of the legislature in order to provide privilege taxation status for some groups of people) as well as uncertainty costs (tax schemes are subject to changes; thus, it is never possible to foresee the future welfare loss for the tax-payers) (Pyle 1991

¹⁰ However, it should be noted that if excise taxes at the same rate are placed on production of both goods then there would not be distortion.

165, Cullis and Jones 1998 175). An optimal taxation system is supposed to minimize total costs.

Thus, an ideal taxation policy should, where possible, include lump-sum taxes to eliminate welfare deadweight losses to the society, as well as try to hold administrative, compliance and other additional costs of taxation to a minimum level. However, here a number of problems arises. One problem lies in determining the right size of the tax. Another problem is how to tax different activities. These issues could create a complex system of lump-sum taxes that would consist of different sums for different industries and different sums for businesses of different size within one industry. However, if the lump-sum tax varies with sales, the number of employees or other variables under the control of the firm, then the lump-sum tax is distortionary – it could be possible to avoid paying higher taxes by altering the firm's behavior (e.g. understating sales, etc.). Thus, second-best policy has to be considered: excise taxes should also to be put into the model when developing a taxation policy.

On the other hand, when imposing a second-best taxation policy, there should be a clear and distinct theoretical rationale for it (Stern 1991 278). If no analysis is done, then the «fallacy of the free-lunch» introduced by Demsetz can emerge when the costs of corrective economic policy are ignored (Dnes 1996 7). It always should be remembered that as the tax rate increases, the welfare losses increase by a greater proportion (Cullis and Jones 1998 174). It can be illustrated by a simple partial equilibrium diagram, presented on Figure 4, where a simple linear demand is depicted. Let's assume that the marginal cost is constant (supply curve is horizontal). The tax first increases the price from 5 to 6 per unit. That price increase imposes a welfare loss equal to triangle ABC. If the tax is doubled and the price becomes 7, then the welfare loss is four times more than the one due to

initial increase: it is a triangle DEB, which is made of triangles DFA, FAE, AEC and ABC. Each of these triangles is equal in area to triangle ABC.

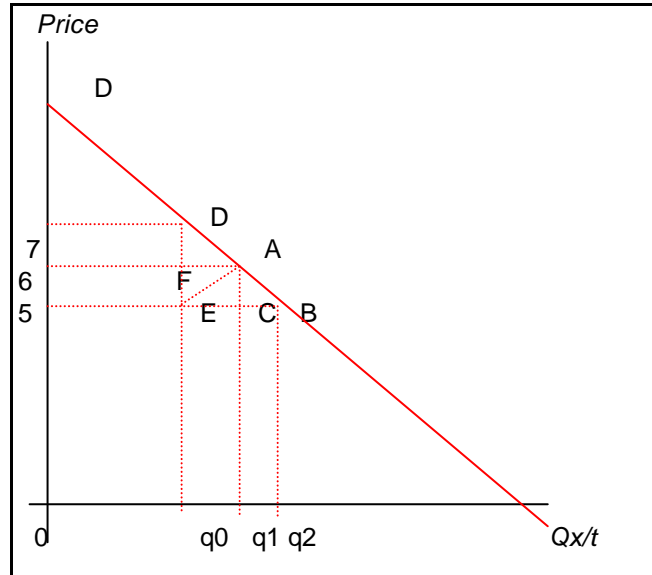


Figure 4. Welfare cost and the rate of tax.

of tax.

Besides, with excise taxes the simplicity requirement is attacked: there will be an additional need to keep records and have audits. On the other hand, individuals have more chances to make mistakes and, consequently, to be punished. In other words, compliance and administrative costs increase.

Excessive compliance costs can lead to tax evasion (e.g. declaring less income to the tax authority) and, consequently, to the emergence of the «shadow economy». However, evasion should not always be considered as an additional loss to the economy. When it helps to offset the costs of tax system, it eliminates some of the excess burden of it and, thus, the impact of evasion is positive. On the other hand, when the share of the «shadow economy» is too big, then evasion leads to biases in the macroeconomic indicators, as well as to misallocation of resources (Pyle 1991 186). Thus, when introducing the excise taxes, corrective policies should be simultaneously prepared.

There are several ways of decreasing compliance costs: imposing low tax rates, introducing severe penalties and creating high probability of audit. As many studies have shown (Pyle 1991, Webley 1983, Dubin 1987, Reinganum and Wilde 1983), the first two policies have not so much effect on compliance costs. On the other hand, compliance costs revealed an inverse relation to a high probability of auditing.

However, such a policy has a trade-off with administrative costs, for a high probability of auditing implies more active monitoring by taxation authorities. Thus, it could be of greater use to try to attack both administrative and compliance costs at the same time through simplifying the requirements of taxation system. In that case, the simplicity criterion would also be satisfied. Hence, in order to reduce administrative and compliance costs it would be of great importance to have a simple tax base and a small number of excise taxes that could be easily calculated.

One more important thing to remember is that we introduce taxation into a dynamic model. The level of taxation has a great impact on investment and entrepreneurship. For instance, if an entrepreneur has to pay an excise tax on the value of sales, there is «tempting» pressure to understate those in order to pay less. In other words, he or she moves to the «shadow», and volume of unofficial economy increases. On the other hand, if an entrepreneur has to pay taxes on capital, he or she has no incentive to invest in physical capital and expand business. Therefore, taxation policy should be developed in such a way that it would stimulate rather than stop the development of enterprises in order for government revenue not to decrease .

Thus, when developing a proper taxation policy to minimize the costs of taxation to the society or, as in the case of Ukraine, reforming the existing taxation system, the two main points that should be taken into account are:

?? for those cases when economic agents are more or less similar in size, business and turnover and it is possible to calculate fixed sums for them to pay, lump-sum taxes are feasible and may be desirable;

?? for the cases when it is impossible to use lump-sum taxes excise taxes should be used, their tax base should be simple, rates and the general number of taxes should not be large.

As a result of such a policy, distortions in the economy due to taxation would be minimized, as well as administrative and compliance costs would be held at the lowest level. Thus, society's welfare would be maximized.

3.2. Application of theoretical conclusions to Ukraine

Theoretical considerations of proper taxation policy are especially important for Ukraine, because research showed instability and inefficiency in all the elements of Ukrainian taxation system (Information-Analytical Documents of «Task-Force» Working Group 1996 9). In particular, it is necessary to take them into account while developing the policy for SMEs sector taxation, because that sector is rather young in Ukraine and, thus, principles of its taxation are underdeveloped.

As polls of entrepreneurs done by various international agencies (TACIS¹¹, USAID¹², HIID¹³, etc.) reveal, the current SME taxation system imposes

¹¹ European Union's Technical Assistance for CIS; TACIS ACE Project, Lviv, polled Ukrainian bank managers and entrepreneurs in spring, 1996; TACIS ACE Project, Kiev, polled owners and managers of small enterprises in Kiev and Khmelnytsky in 1997; Agency for Development of Enterprise (TACIS program) polled Kiev-based entrepreneurs in small business in February, 1996. Results of the polls can be found in *Analysis of Barriers for Small and Medium Business in Ukraine*, Newbiznet: Kiev, 1998

excessive tax rates, and demands sophisticated tax calculation method as well as complicated and labor intensive reporting procedure. To avoid, using the language of entrepreneurs, «tax system lethal attack» the majority of entrepreneurs understate the tax base or, in other words, move to the informal economy (Analysis of Barriers for Small and Medium Business in Ukraine 1998 20). It could be concluded that current SME taxation is burdensome for the enterprises and imposes high compliance costs. It is logical to expect that the welfare losses from such a policy are huge. First of all, the share of unofficial economy grows¹⁴, and, consequently, the government loses revenue. Second, tax evasion leads to additional stronger enforcement procedures that increase enforcement costs.

Looking at the above mentioned considerations and trying to apply them to Ukraine to improve the current situation in taxation policy, it is possible to say that using lump-sum taxes in Ukrainian SME taxation may be successful. The majority of small and medium enterprises (51.4%) operate in retail, marketing and service sector; many of them have similar size and value of sales (Analytical report on State Committee for Entrepreneurship Development 1998). Thus, it could be possible to estimate lump-sums for a big group of enterprises.

¹² The United States Agency for International Development, is the independent government agency that provides economic development and humanitarian assistance to advance US economic and political interests overseas. Its project NEWBIZNET, aimed to support small and medium enterprises in Ukraine, has conducted many polls, among which are polls on fixed tax in 1998 (referred to later), analysis of barriers to small business in Lviv oblast in 1998 (results could be found in *Barriers to the Development of Small and Medium Business in Ukraine*, Newbiznet: Kiev, 1998)

¹³ Harvard Institute for International Development, is Harvard University's multidisciplinary center for coordinating development assistance, training, and research on Africa, Asia, Central and Eastern Europe, and Latin America. Its Project of Economic Reform in Ukraine polled Western businessmen doing or intending to do business in Ukraine in March, 1993, in Kiev. Results of the poll can be found in *Analysis of Barriers for Small and Medium Business in Ukraine*, Newbiznet: Kiev, 1998

¹⁴ According to some economists, the «shadow» economy in Ukraine amounts to 25-50% of GDP. According to pessimistic estimates, 2/3 or 4/5 of the branches of the national economy are controlled by «shadow» businesses (Barriers to the Development of Small and Medium Business in Ukraine 1998 12)

The success of that policy can be easily evaluated: if government revenues received from the group that started paying lump-sum taxes would increase compared to what was paid before the new policy (without any changes in enforcement), then this policy has a positive effect on the economy and, thus, the tax system is made more efficient.

On the other hand, development of the SME sector could be stimulated by a decrease of compliance costs. As has been mentioned in the previous section, it can be done through decreasing the number of taxes paid by small and medium enterprises and by simplifying accounting procedures. The effect of that policy can be evaluated through an increase of the quantity of those enterprises that have decided to use the new simple accounting system or by general increase of the number of small and medium enterprises.

3.3. Conclusions

According to the theory of taxation, an efficient taxation policy should minimize costs of taxation to society, per unit of tax revenue raised. When economic agents are more or less similar for their size, business and value of sales and it is possible to calculate fixed sums for them to pay, lump-sum taxes should be imposed. This would be of especial importance in transition economies when authorities do not have the capacity to effectively impose sophisticated tax systems. Presumably, as the market economy matures, the tax system might take on some of the elements of tax systems found elsewhere.

If it is impossible to use lump-sum taxes, then second-best taxation (excise taxes) should be used. However, the tax base should be simple, rates and general number of taxes should not be large or tax rates should equal.

As it has been shown, in Ukraine it could be possible to try to stimulate the development of SME sector and reduce welfare losses to the society due to taxation by implementing the theoretical ideas on «fair» taxation policy. The impact of this will be discussed in the next Chapter.

Chapter 4

ANALYSIS OF CURRENT CHANGES IN UKRAINIAN LEGISLATION ON TAXATION OF SMALL AND MEDIUM ENTERPRISES

4.1. Reforming of taxation of small and medium enterprises in Ukraine

Starting discussion on taxation of small and medium enterprises, it is worthwhile to briefly review the recent development of the Ukrainian SME sector in general because current problems with taxation policy can be traced back to the political mistakes made at the very beginning of the process of tax policy creation..

In the former Soviet Union, this sector was not developed. The main reason for that was ideological. Small and medium enterprises, especially with private ownership, were considered to be a part of a capitalistic economy and, thus, inappropriate for socialist development. Competition was unacceptable in a planned economy. Therefore, the main priority of the soviet economy was the creation of large state enterprises.

During the development and existence of the social system of management, the so-called situation of «society without taxation» was achieved. In practice, all the taxes, except for income tax and tax for having no children, were paid by enterprises. That psychologically underlined «the state concern for the common worker» (Small Business in Ukraine 1997 39).

The banking system was tightly connected to tax collection and payment. Taxes were pure transfers from one account to the other (Gandhi and Dubravko 1992 146). All the profits earned above that level set by the plan were automatically withdrawn from the enterprises bank accounts and gone to the state that then used these excess profits as subsidies for loss-making enterprises. Thus, there was no

incentive to be profitable (Kornai 1986 9). On one hand, it was impossible for the enterprises to take money from their accounts except for salary payments. At the same time, a ruble in the bank was worth less than a ruble in cash¹⁵ – there were different prices for commodities if they were bought by cash or by cheque of the enterprise; «cash» prices were cheaper.

After Ukraine gained independence in 1991, international analysts and consultants first started talking about a transition to a market economy, where small and medium enterprises are an important element of the economy. In 1991, the Law of Ukraine «On Entrepreneurship» was adopted. Later, a specialized government agency was created that dealt with the newly emerging agents: the State Committee for Assistance to Small Enterprises and the Entrepreneurship. At the same time, the State Fund for Entrepreneurship Support and Competition Development was established. In 1993 a long-term Program of Governmental Support of Entrepreneurship was initiated; State Entrepreneurship Committee developed the action plan accordingly.

However, all those measures had little positive effect on SME sector development. After a strong increase of small and medium enterprises in 1991-1992 (increased by 157%¹⁶), in 1992-1993 there was a decline in this sector. The trend among SME worsened in 1994. In 1996 an absolute decrease in a number of small and medium enterprises was observed (1993 – 44.5% increase; 1994 – 6.4% increase; 1995 – 14.7% increase; in 1996 – -6.6%). That could be

¹⁵ As has been mentioned, it was mostly impossible to convert money from banking accounts into cash that led to existing of cash and non-cash money: enterprises could use cash only in paying salary; non-cash money was used in making payments between enterprise. That led to much economic violence: usage of «dead souls» to get extra cash and including more goods and services (that were not admittedly fulfilled) into costs, as well as other ways of artificially increasing costs (Small Business in Ukraine 1997 39).

interpreted not only as an impact of overall recession, but also as the influence of a bad economic environment on small and medium businesses that did not improve as new policies had been introduced (Small Business in Ukraine 1997 49).

Such a situation could be explained by several reasons: the breach of old economic connections and inability to establish new ones, rapid changes in economic environment, old mentality of Ukrainian people and other difficulties of transition period. However, one of the reasons for that poor development was a «mosaic» of transformation of the Ukrainian taxation system occurred, i.e. elements of taxation systems of different countries were borrowed while here was no new overarching conception of taxation policy developed and old ways of tax inspectors operation were left. The main focus of attention was given to enforcement methods, as well as to strengthening of administrative and criminal sanctions against taxation violations (Small Business in Ukraine 1997 39).

Thus, in 1996 everything started over from the very beginning. The Cabinet of Ministers of Ukraine approved the Concept for Government Small Business Development Policy. In 1997 the Program for Small Entrepreneurship Development for 1997-1998 was adopted. In July, 1997, regulations for the State Committee for Entrepreneurship Development (SCED) were established. SCED changed the former State Entrepreneurship Committee that in 1995 became a Department for Small Entrepreneurship State Regulation and Development Analysis, which works as a task subdivision within the Ministry of Economy of Ukraine. Actually, with emergence of SCED a real transformation of taxation policy on SME sector started.

¹⁶ Such a big increase in the number of small and medium enterprises could be explained by the adoption of Laws of Ukraine «On Entrepreneurship» and «On Entrepreneurship in Ukraine», that convinced people to try themselves in legal businesses. Besides, there were a lot of taxation privileges adopted for newly-registered small businesses, that were eliminated later (Small Business in Ukraine 1997 48).

One of the first steps taken by the new Committee was development of local programs for entrepreneurship development for all the regions of Ukraine. The main purpose of those programs were to find legal, informational, finance, as well as organizational solutions of the problem of SMEs support on a regional level. The other direction of SCED activity was the creation of new approaches to taxation of small and medium enterprises. The main impact of these measures will be considered in the two next sections.

4.2. Impact of fixed (lump-sum) tax on the SME sector in Ukraine

One of the important achievements of the State Committee for Entrepreneurship Development was lobbying for a law on fixed (lump-sum) tax, that was approved on February 13, 1998, as the Law of Ukraine «On Amendments to the Decree of Cabinet of Ministers of Ukraine «On Personal Income Tax». According to that law, citizens who are engaged in entrepreneurial activity without enlisting hired labor or by enlisting members of their families may buy a license, whose price is set by local authorities. The price of this license must not exceed 200 UAH per calendar month. To start paying that fixed tax, citizens have to fulfill the following conditions: the number of people listed in the license must not exceed 5 (or the sum of fixed tax may be increased by 50% or less); turnover during the last 12 months must not exceed 119, 000 UAH; an entrepreneur may work at the marketplace and pay the market tax; an entrepreneur must not be engaged in liquor or tobacco products trade. Those who pay the flat tax receive the following rights: there is no need to keep mandatory accounting of records; trade activity in retail trade need not be licensed; incomes that are covered by the fixed tax are not included in the income report for the end of the year (Law of Ukraine «On Amendments to the Decree of Cabinet of Ministers of Ukraine «On Personal Income Tax» 1998).

The advantages of the new tax are that entrepreneurs who pay it are excluded from making payments to the pay-roll tax, deductions and fees on roads, the trade tax, contributions to the Funds for Social Protection of the Population, contributions on mandatory social security and contributions to the fund for social protection of invalids. Also accounting system is simplified.

As those entrepreneurs, by the Law on Fixed Tax, pay a fixed sum, despite the level of income, it could be considered as a lump-sum tax. As it has been shown in the previous section, such a policy may have positive welfare effect on Ukraine. It is also worth mentioning that this lump-sum tax will be nondistortionary as long as the amount of the tax is not too high. If it is set almost as high or higher than the income generated then the individuals would likely try to evade it or be forced to shut down.

Before the Law was approved, it was expected that a fixed tax would decrease the number of obstacles to small and medium enterprises, and that it would help to «bring out of the shadow economy» at least 1,5 mln entrepreneurs that evade paying taxes (Golubenko 1998 4).

In May, 1998, four months after the Law adoption, SCED evaluated the impact of new taxation policy. The evaluation was made in the form of a poll. The poll was done by NEWBIZNET (project of USAID) together with International Centre of Policy Studies (ICPS)¹⁷. Entrepreneurs that work in marketplaces were surveyed during the last week of May in 12 Ukrainian cities. 368 entrepreneurs were asked to fill in the questionnaire designed by ICPS.

¹⁷ International Center of Policy Studies, as an independent think tank, has an aim of improving Ukrainian policy research and dialogue and the participation of the public at the formulation of policy and the monitoring of reform.

According to that research, 77.5% of respondents in the marketplace pay the fixed tax by buying a license, or being included in the license of other persons. Among them 45.2% answered that the conditions of their businesses improved after the fixed tax was implemented. In the places where respondents did not indicate improvement, they evaluated the effect of fixed tax as neutral – 33.3% responding so. 42.2% of entrepreneurs surveyed were expecting a positive influence of the tax on their activity in future; a big part of the rest did not define that for themselves – 28.9% (Results of Poll «Fixed Tax in Ukraine» 1998).

Thus, it can be concluded that in general the fixed tax had a positive influence on entrepreneurs that can pay it. On the other hand, the Head of State Taxation Administration of Ukraine, M.Azarov, in his letter to the Cabinet of Ministers #426/08/17-0410 of May 7, 1998, emphasized that since the establishment of fixed tax the amount of taxes collected from those who decided to buy licenses (25%¹⁸ of entrepreneurs) increased by four times compared to amount collected from the same group before the fixed tax was imposed. In general, taxation revenue gathered during that period of time increased. In the same letter, based on those results, M.Azarov even proposed to make the fixed tax not voluntary but obligatory for all physical entities that are engaged in entrepreneurship activity in the market place (Letter to Cabinet of Ministers #426/08/17-0410 1998).

However, it is also worth mentioning that though, in general, the fixed tax satisfied the expectations of those who lobbied for it, it also has several weak points. First, it did not simplify the accounting system, as was expected. Though now entrepreneurs have no obligation to keep accounting records, many of them pay

VAT, that is very complex to compute. Thus, there is some need to maintain book-keeping records. Then, there is no strict list of activities that can be taxed by fixed amounts. Thus, it can be paid even by private lawyers or notaries that could lead to a certain discrimination among entrepreneurs, as well as to a decrease in government revenues. The value of the services sold by private lawyers or notaries are much higher than value of sales of those who work in market places.

Another weak side of the tax is that the limit on value of sales provides an incentive for entrepreneurs to understate their turnover. One more drawback of the law is that an entrepreneur is able only to enlist his or her relatives in the license. As a result, cheating appears: people that are not real relatives are written to the license or the entrepreneur hires labor unofficially for cash, thus, moving some activity back to the «shadow economy».

Nevertheless, despite its drawbacks, as it has been shown, establishment of the fixed tax had a positive impact on the entrepreneurs, as well as it increased government revenue, as it was predicted in the previous section. Therefore, it can be concluded that imposing a lump-sum tax on a certain category of the SME sector did improve the economic environment for economic activities of small entities. It could be due to the fact that a fixed fee did not alter the behavior of entrepreneurs. As it has been mentioned, it is possible to alter activity of a firm, e.g. understate value of sales, to pay less taxes: the sum to pay is sufficiently low and those who decided to pay it did not avoid or evade it. On the other hand, it is certainly administratively simple.

¹⁸ As it could be noticed, this number is much less than previously mentioned 77.5 %. Actually, it should be considered carefully. According to the law, an entrepreneur that buys a license is able to include five of his relatives that work with him; every additional person, besides these five, also written in the license, will pay only half of a license price. That gave a push for creating «stars» – several entrepreneurs collude to buy a single license in order to pay less. One of them is registered as an «owner», and the others are his or her employees. 25% is a number of «owners». In reality, number of entrepreneurs that pay fixed fee can be up to 80%.

4.3. Impact of policies, that are aimed to reduce compliance and administrative costs – (6% + VAT) schedule

However, as has been already mentioned in the previous chapter, lump-sum taxation is not able to solve all the problems due to its limitations: there are many cases when it cannot be imposed – it could be hard to figure out the exact amount to be paid, or enterprises are too different in size, or value of sales. If a lump-sum varies with criteria that are under the control of taxed firms, such a taxation scheme could be distortionary. Therefore, the State Committee for Entrepreneurship Development, in order to promote further the SME sector development, prepared another draft law «On Changes and Amendments to Some Legislative Acts of Ukraine on Taxation», under which small and medium enterprises-legal entities can choose to pay single tax. This law was adopted as an Enactment of President of Ukraine on July 3, 1998.

According to the Enactment, subjects of entrepreneurial activity-legal entities whose turn-over does not exceed 250,000 UAH and number of hired labor is not more than 10 persons may choose to use a simplified accounting system, paying a single 6% tax on value of sales (services). Those enterprises that pay a single income tax do not pay corporate income tax, the tax on land, the deduction on natural resources usage, the pay-roll tax, the deductions and fees on roads, the trade tax, contributions to the Funds for Social Protection of the Population or contributions on mandatory social security, contributions to the fund for social protection of invalids (Enactment of President of Ukraine on Simplified Taxation System and Accounting for Subjects of Small Entrepreneurship 1998).

As just seen, the main purpose of that law was to reduce the compliance costs to entrepreneurs as well as administrative costs for tax authorities by decreasing the number of taxes, simplifying the tax base, improving accounting procedures and,

consequently, eliminating the «danger» of fines after tax inspections. As a result, it was expected that the difficulties of the post-registration period would reduce and the rate of growth of the SME sector would increase. It was also believed that the role of the «shadow economy» would not be so strong. Taxation revenue increase was not the main objective of that law, though due to increase of a number of SMEs, it was expected that government income would rise (Barriers to the Development of Small and Medium Business in Ukraine 1998 25).

In order to investigate the impact of a new taxation policy, the Association for Promotion of Entrepreneurship Development in Ukraine «Yednannya (Unity)» in October, 1998, held a poll among entrepreneurs and subjects of small and medium entrepreneurship. According to the database of «Yednannya», 2000 potential respondents (enterprises that actively worked during 1997) were chosen.

As it turned out, not many enterprises switched to the simplified taxation and accounting system: approximately 30% of enterprises surveyed. The main reason for it was that a single tax did not exempt enterprises of paying VAT. As in the case of the fixed tax, no real simplification of accounting occurred. Another reason is a limited range of enterprises are eligible to pay the single tax.

Though it is hard to evaluate the impact of that law on the growth of the sector – only a year has passed since its adoption, and the Russian Crisis may have hurt the SME sector a lot – it can be said that observed increase of SMEs was not as big as was predicted. The number of small and medium enterprises increased only by 52, 000, though this number was expected by government to be twice as big. Nevertheless, as it has been mentioned, the reason for that is not only taxation policy.

Thus, a conclusion can be made that the law on a single tax did not fulfill its purpose: compliance costs did not decrease, economic environment showed no improvement. Thus, the establishment of a single tax in that form had no effect on entrepreneurs and, consequently, on society.

4.4. Conclusions

In this Chapter two current changes in taxation policies on SME sector have been analyzed. As it turned out, the imposition of a fixed (lump-sum) tax had a positive impact on the economy: approximately 80% of entrepreneurs decided to buy license; taxation revenues from this group increased by four times, mostly due to decrease of the level of evasion. On the other hand, the attempt to decrease compliance and administrating costs was not successful. The main reason for it was that entrepreneurs still had to pay VAT and, consequently, no real simplification of taxation and accounting requirements occurred.

Chapter 5

TAXATION OF SMALL AND MEDIUM ENTERPRISES: FURTHER WAYS OF IMPROVEMENT

5.1. Single 10% tax schedule

As it has been shown in the previous chapter, not all taxation policies introduced to the SME sector in Ukraine fulfilled their purpose. The question is what has to be done or improved in current taxation policy in order to achieve more successful and feasible results.

Currently there is a great deal of discussion about a single 10% tax on value of sales. (As is the case with the (6%+VAT) schedule), it is proposed to be voluntary. The principal difference of that tax from the 6% tax is that 10% tax is in lieu of VAT, as well as other taxes. Besides, that 10% single tax law is proposed to extend to the medium enterprises with hired labor up to 50 persons without any limitation on value of sales (Project of the Law of Ukraine «On Single Tax»). Thus, the main purpose of it is to simplify the accounting system as well as to increase the number of enterprises that can use that scheme.

The tax rate of 10 per cent was determined in two independent ways. First, according to the information of National Bank of Ukraine, total value of sales through the electronic system of National Bank for the period of 10 months of 1997 was approximately 540 bln UAH. If taxes, budgetary, inter-banks and enterprises-banks transactions are subtracted from that number, then potential single-tax base can be defined as 300 bln UAH. On the other hand, according to the data of Small Enterprises Department of the Ministry of Statistics of Ukraine, small and medium enterprises paid 26,121 mln UAH of taxes to the budget. That

comprises 8.7% of the potential single-tax base (Introducing the Single Tax: Some Aspects of Potential Influence the Economy 1998 6).

At the same time, a poll was proposed to entrepreneurs by «Business» newspaper on single-tax rate and preferable single-tax base. According to that survey, average single-tax rate appeared to be 11.3%; entrepreneurs defined value of sales as the best tax base for the single-tax (Results of Small Businesses Survey on Possible Models of a Single Tax 1998). Thus, 10% rate of a single-tax can be considered as a mean of 8.7 and 11.3.

The advantages of the single 10%-VAT inclusive tax are that it decreases compliance and administrating costs due to simplifying of accounting system as well as stimulates growth of the SME sector.

The potential impact of a new tax schedule was evaluated by the Group of Macroeconomic Reform¹⁹. According to the research, that tax would have a positive impact on the economy. First, government revenues would not decline; more probably, they would even rise. Second, a 10% single tax would promote a shrinking of the «shadow economy» – experts the Group consider the rate of a single tax as being close to the «opportunity cost of being in the shadow». As a result, they expect that after introducing the new tax schedule, official GDP would rise. Then, a real simplification of accounting system would be achieved and, consequently, that tax would result in more radical changes than the 6% single tax + VAT system (Introducing the Single Tax: Some Aspects of Potential Influence the Economy 1998 7).

Independent evaluation of the potential impact of a single tax was also done by the Association for Promotion of Entrepreneurship Development in Ukraine

¹⁹ Project of HIID in Ukraine

«Yednannya (Unity)». In this research it is emphasized that with a 10% tax enterprises will receive an additional incentive to use their capital through the banking sphere as well as use credit cards (Single Tax for Small Business 1998 6).

However, there could be negative impact of the new single tax as well. In the same research of Group of Macroeconomic Reform, analysts also warn that if there is a choice between several accounting systems, enterprises would choose one, where they would pay less; thus, it is possible that government revenues may fall. Nevertheless, authors of the research conclude that if the principle of voluntary choice between «normal» and simplified taxation is introduced, then the final effect would be positive – the effect of tax evasion decreases and creation of new enterprises is expected to cover and even exceed that negative outcome (Introducing the Single Tax: Some Aspects of Potential Influence on the Economy 1998 3).

The other weak point of the 10% single tax is that it is based on a close control of the value of sales. It is rather easily fulfilled if all the sales are done through the banking system. However, if an enterprise operates with cash, as in the trade sector, then there is an incentive to understate the value of sales by not registering certain amount of deals (Single Tax for Small Business 1998 6). However, that draw-back can be easily eliminated by using special trade licenses (this issue is discussed in the next section).

The other negative result of a potential single tax is an increase in lobbying costs mentioned in the Chapter 2. As a 10% single tax would simplify the tax base and accounting system, there will be no need to keep a great number of accountants and tax inspectors. It is possible that the number of enterprises punished for the mistakes done in calculating the tax will also decrease. It is logical, that Taxation State Administration of Ukraine lobbies against that draft law.

Thus, it is possible that introduction of a new single tax will have a real positive impact on economic environment of the SME sector and welfare of society as a whole, due to the reduction of compliance and administrating costs of taxation, as theory predicts. Anyway, its performance is expected to be much more successful than that of the (6% + VAT) schedule.

5.2. Special trade licenses

As it has been mentioned above, introducing a single tax to the trade sector could cause some problems due to high costs of monitoring of the value of sales done for cash. However, it was proposed to introduce special trade licenses for small and medium enterprises of that sector; licenses must be bought instead of paying a single tax on value of sales..

According to the Law project «On Changes to the Law of Ukraine «On Licensing of Certain Types of Entrepreneurial Activity», special trade licenses should be given to small and medium enterprises, engaged in trade for cash, by local authorities. The price of the license should also be defined by a special local unit. It was expected that the introduction of the special license would give an incentive to entrepreneurs not to hide their cash transactions for they would not influence the amount of taxes paid by a firm. As a matter of fact, it is even planned for the enterprises that buy special trade licenses not to keep obligatory records of cash transactions. That would also cause increase the volume of trade and expand their business by hiring more labor.

As an experiment, it was decided to introduce the new licensing policy into several regions of Ukraine. Enactment of Cabinet of Ministers of Ukraine #826, adopted in June, 1998, defined those regions, the total number of which is eleven. The starting date of experiment was July 1, 1998.

The impact of an experimental policy was evaluated by the State Taxation Administration of Ukraine half a year later, in December, 1998. According to the Letter of the Head of State Taxation Administration of Ukraine, M.Azarov, to the Cabinet of Ministers of Ukraine, due to the new taxation policy government revenue increased: the group of enterprises that bought special trade licenses increased their budget payments by two times. On the other hand, the local budget revenues from special trade licenses increased by 3.5 times. (Letter of the Head of State Taxation Administration of Ukraine #1395/08/15-1311 1998).

The positive impact of trade licenses was also emphasized by many entrepreneurs in experimental zones. It was observed that some of them started expanding their businesses turning a small enterprise into a medium one. As a result, many letters from regional councils of different parts of Ukraine came to the Cabinet of Ministers with the request to include their regions to the number of experimental zones. Thus, the State Committee for Entrepreneurship Development prepared a proposal to add 18 regions to the experiment (Letter of SCED to State Taxation Administration #10-154 1999).

However, that project of Law also possesses some draw-backs. First, together with a fixed (lump-sum) tax special trade licenses create a problem of double taxation. Nevertheless, it can be eliminated by introducing a special article to the Law, where it is said that SMEs can choose between buying a special trade or a fixed (lump-sum) tax license.

The next weakness of the Project is similar to the one of fixed (lump-sum) tax. There is no limit of value of sales of an enterprise that can buy a license. It means that every expensive boutique is able to buy a trade license and, thus, the government can lose revenue. However, on the other hand, it could have a positive aspect as well: if a factory is not able to find a wholesale buyer for its production, it

can open a small store, buy a trade license and try to sell the goods through that store. The more small stores of that kind are opened, the more revenue the government will receive.

One more draw-back of the project is that it does not set a cap for the special trade licenses. According to the Letter of the Head of State Taxation Administration of Ukraine, the highest price of a license set by local authority in experimental zones was 137 UAH per month. Definitely, it is rather expensive; thus, not every potential buyer of special license will purchase it. However, local authorities are elected by the local population. Now in Ukraine a fall of population election activity is observed. Thus, if an entrepreneur decided not to vote today, the next time he or she would definitely think whether is it more costly to ignore elections or elect a person who will support development of small and medium enterprises.

Despite those draw-backs, a positive impact of a new licensing policy was observed. Besides, there is time to improve the weak points – this policy is still experimental. However, it can become a good supporting measure for the single 10 % tax.

5.3. Conclusions

The 10% single tax schedule (in lieu of VAT and other taxes) could be a good policy of further simplification of accounting system as well as decreasing of compliance and administrative costs. As available research has shown, government revenues would not fall with its introduction. Many entrepreneurs prefer that schedule to the (6%+VAT) tax. However, this policy possesses some draw-backs, the most important being it is hard to monitor cash transactions. Introduction of special trade licenses could eliminate this problem. The use of trade

licenses has been implemented in several regions as an experiment. It has shown to have a positive impact on taxation revenues as well as on entrepreneurs.

Chapter 6

CONCLUSION

As it has been shown, in order to promote development of small and medium enterprises in Ukraine, as well as reduce the costs of taxation to the society as a whole, taxation policy changes were undertaken in two directions. First, a fixed tax on a certain layer of the SME sector was imposed. Then, there was an effort to introduce a single tax for a sub-category of small and medium enterprises. The first policy can be considered as a lump-sum taxation; the second one can be viewed as means of addressing compliance problems and administrative taxation costs reduction. Both changes were supposed to have a positive effect on SME sector development, as well on the society in whole.

Available research suggests that the fixed tax, applicable to small enterprises-physical entities that do not enlist hired labor or enlist members of their families, value of sales of which during the last 12 months does not exceed 119,000 UAH and that do not deal with liquor or tobacco trade, had a positive impact on the economy (compared to previous situation of taxation of SMEs). In particular, it had a positive impact on the entrepreneurs (according to polls, the fixed (lump-sum) tax improved their businesses), as well as it has increased government revenue.

However, the second one, namely a 6% single tax on value of sales for legal entities with hired labor up to 10 people and value of sales during the last 12 months not exceeding 250,000 UAH, did not fulfill the set objective – in practice, compliance costs were not reduced; no observed effect was achieved.

On the other hand, the results of surveys among entrepreneurs also revealed that a large number of entrepreneurs would be willing to pay the proposed 10% single tax on firms' revenue and reduce the volume of unofficial transactions. Thus, a new taxation policy for the SME sector is being prepared. It is supposed to be more radical – the VAT is planned to be included to the new single tax schedule that will lead to a real reduction of compliance and administrative costs, which is a main objective of a single tax.

However, in order to eliminate certain distortions of the potential policy, it should be implemented together with trade licenses. That will help to achieve the stated objective of simplification and efficiency and, consequently, it could become possible that a single tax will have a positive impact on the economy as it is predicted by theory.

Though tax policy for small and medium enterprises in Ukraine is still far from being perfect, a lot of attempts are being made to improve it. If all the future policies are thoroughly evaluated, there is hope that in the future the taxation system of Ukraine will achieve the three main objectives of taxation: efficiency, equity and simplification. In that case, taxation would not hinder but rather stimulate the development of the SME sector and it would become an important part of the Ukrainian production sector.

As the market economy in Ukraine matures, then a movement to other tax regimes may be called for. However, for the transition, a core system that minimizes costs and encourages firm development is in order.

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APPENDIX

Appendix 1

SUMMARY TABLE OF CURRENT POLICIES OF UKRAINE ON SME TAXATION

Name of the Tax	Document	Tax Base	Tax Rate/ Form/ Amount	Conditions to Apply	Advantages of the Tax	Disadvantages of the Tax	Notes
Fixed (lump-sum) tax	Law of Ukraine «On Amendments to the Decree of Cabinet of Ministers of Ukraine «On Personal Income Tax», # 129/98-VR, 1998		License, up to 200 UAH	?? physical entities; ?? no hired labor; ?? value of sales during the last 12 months <119,000UAH; ?? should not be engaged in liquor or tobacco trade.	?? exempts from paying: ?? pay-roll tax; ?? deductions and fees of roads; ?? the trade tax; ?? contributions to the Funds for Social protection of the Population; ?? contributions on mandatory social security; ?? contributions to the fund for social protection of invalids; ?? exempts from keeping mandatory accounting records – simplifies the accounting system; ?? incomes covered by the fixed tax are not included to the income report for the end of the year.	?? does not exempt from paying VAT, thus, still need to maintain book-keeping records; ?? no strict list of activities that can be taxed; ?? limit on value of sales provides an incentive to understate them; ?? limit on hired labor brings an incentive to hire people unofficially for cash.	Entrepreneur can include up to 5 relatives in the license; additional people (above those five) have to pay a half of the license price.
6% single tax (6%+VAT)	Enactment of President of Ukraine on simplified	Value of sales	6%	?? legal entities; ?? hired labor up to 10	?? exempts from paying: ?? pay-roll tax;	?? does not exempt from paying VAT;	

schedule)	taxation system, reporting and accounting of subjects of small businesses, #727/98, 1998			people; ?? value of sales during the last 12 months <250,000UAH. ?	?? corporate income tax; ?? the tax on land; ?? the deduction on natural resources usage; ?? deductions and fees of roads; ?? the trade tax; ?? contributions to the Funds for Social protection of the Population; ?? contributions on mandatory social security; ?? contributions to the fund for social protection of invalids; ?? reduces compliance costs; ?? reduces administrative costs; ?	?? not many firms can apply.	
10% single tax (10%-VAT inclusive schedule)	Project of the Law of Ukraine «On Single Tax»	Value of sales	10%	?? legal entities; ?? hired labor up to 50 people; ?? no limit on value of sales ?	?? exempts from paying: ?? VAT; ?? pay-roll tax; ?? corporate income tax; ?? the tax on land; ?? the deduction on natural resources usage; ?? deductions and fees of roads;	?? could decrease government revenues; ?? hard to monitor value of sales in the trade sector (can be eliminated by introduction of trade licenses); ?? increase of lobbying	

					<p>?? the trade tax;</p> <p>?? contributions to the Funds for Social protection of the Population;</p> <p>?? contributions on mandatory social security;</p> <p>?? contributions to the fund for social protection of invalids;</p> <p>?? reduces compliance costs;</p> <p>?? reduces administrative costs.</p>	costs.	
Special trade licenses	Law project «On Changes to the Law of Ukraine «On Licensing of Certain Types of Entrepreneurial Activity»		License	<p>subjects of entrepreneurial activity that are engaged in:</p> <p>?? wholesale trade;</p> <p>?? retail trade;</p> <p>?? trade-production sector (public nutrition), using cash and credit cards transactions.</p>	<p>?? no incentive to hide transactions;</p> <p>?? incentive to increase volume of trade;</p> <p>?? incentive to expand businesses.</p>	<p>?? together with the fixed (lump-sum) tax creates a problem of double taxation (can be eliminated);</p> <p>??</p> <p>?? no limit on value of sales;</p> <p>?? no price-cap for the licenses.</p>	

