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# Taxation of Small Business through the Creation of Special Conditions: the Experience of Foreign Countries

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**Abstract:** Business taxation is that part of any country economy that always needs attention and improvement. At the same time, each country chooses its priorities in the implementation of tax incentives for entrepreneurship, since it has its own characteristics of economic and anthropogenic development, the development of science and technology, and structural development. Sometimes the same tax conditions created in different countries give different results. Therefore, each country is in search of its own, sometimes combined, or borrowed, but adapted for its locality, conditions for taxing entrepreneurship. The study is not exhaustive, but it makes it possible to study a number of conditions created in different countries for the taxation of entrepreneurship and draw conclusions about the effectiveness of these conditions.

**Keywords:** taxation, entrepreneurship, tax incentives, tax regime, tax instruments, forms of taxation.

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**Introduction.** Many countries have adopted a special taxation regime for small businesses. There are several reasons for this. Small business is an important area of the functioning of the economy. Small businesses are easier to adapt to changing market conditions than large ones because they are more flexible. The development of this economy sector is especially important during the restructuring of the economy, when unemployment is growing due to a reduction in production in entire sectors, as it allows you to increase employment.

The issue of providing small businesses with tax advantages is quite controversial. In particular, the presence of scale economies can lead to the fact that the minimum effective size of production in certain types of activity falls on rather large output volumes and requires the involvement of a significant number of factors that are inaccessible to small businesses. However, the possibility for small enterprises to compete with relatively large ones can be considered as one of the conditions for freedom of entry into the industry, which not only contributes to the presence of competition where it is appropriate, but creates the prerequisites for the threat of entry for a potential competitor in case of market power abuse by an enterprise operating in the industry.

The data show that small enterprises, whose management structure has less bureaucratic features, are much more mobile and adapt faster to changing market conditions, as well as to shocks in the economy.

Innovative activity is often carried out at the level of small business. Large business, of course, has significant advantages in the ability to carry out innovative activities (but not necessarily a great interest) and in obtaining the necessary information, the funds necessary for research or for the acquisition of new developments are more available to it, a large enterprise due to its greater availability diversification may take more significant risks on

individual projects. However, in cases where, at the initial stages of activity, the value of employee qualification is higher than the cost of other factors of production, the advantage of small enterprises is possible.

The development of small business in the country usually significantly alleviates the problems associated with unemployment. The practice of all kinds of loans and benefits to the unemployed who want to start their own business is widespread in the world. And in Uzbekistan, there is another reason to support small business: it is necessary to promote the formation of the so-called middle class - a layer of independent, self-sufficient citizens. To achieve this goal, the number of small enterprises and the scale of their activities are less significant, it is more important that a person has the potential opportunity to open a small enterprise with reasonable risks and costs.

A strong justification for establishing tax preferences for small businesses is the difference in tax costs depending on the size of the enterprise. For small businesses, even the explicit costs of paying taxes are especially sensitive, since, while being practically constant for the enterprise as a whole, they are higher for small businesses than for large ones, per unit of output. In addition, the total opportunity cost of paying taxes is higher for small businesses, because large businesses can use accounting results that they need for internal purposes and are not necessary for small businesses to determine tax liabilities.

It is more difficult for small businesses to obtain borrowed funds at an acceptable interest rate, so they finance investments mainly from their own funds. But if interest on borrowed funds, albeit with restrictions, is deductible from the income tax base, then the opportunity cost of raising equity capital is not deductible when applying income tax.

At the same time, there are also problems associated with tax evasion by small businesses. If legal tax evasion through the use of loopholes in the legislation is more accessible to large taxpayers, then tax evasion by concealing revenue, providing false reporting, doing business without registration are typical of small businesses. The reason for this is not only a greater opportunity to avoid punishment, but also excessively high costs of compliance with the law (tax amounts due and the costs of maintaining and reporting) for small values of income.

### **Research methodology.**

In the process of working on the study, the author based on current trends, legislative and regulatory support, development of the county's tax policies, approved by legislative and regulatory acts, used a systematic approach, economic and scientific analyses.

**Literature review.** The study of the theoretical foundations the entrepreneurial activity, which have made a great contribution to the development of the theory and methodology of small business development are: E. Dolan (1988), G. Carter (1991), P. Drucker (2001), D. Lindsey (1988) and others.

According to the overwhelming number of scientists, in particular M. Polil (2005), most countries of the world develop their state primarily through tax sources, whether direct taxes or indirect taxes. According to E. Marandu (2014), the importance of tax revenues determines their significant role in the social, political and economic development of countries. The taxation system in force in any state naturally has a direct impact on the totality of funds generated by the entity for its own development, that is, the modernization of production, the introduction of innovative developments, investment activities, entering new markets, improving product quality, etc. (Baeva, E. et al. (2020)).

As a rule, the purpose of taxation is the receipt of income by the state, but J. Akujuobi (1988) thinks otherwise. He notes that this function of taxation in recent years may be called into question, since the government has the right to create money. However, J. Naiyeju (1997) believes that the purpose of income taxation is still important. The revenue function of

taxation is still important in any economy. The government can generate the necessary income through taxation.

Taxation is not only a tool for generating income, it can always be used to achieve numerous economic goals. S. Rabi (2003) believes that the government can use taxation to achieve such economic goals as stimulating consumer demand for production, investment and savings. A. Buhari (2004) divided the goals of taxation into four main areas: income generation, income distribution, regulation and stabilization of the economy. J. Hanson (1988) listed the importance of taxation as follows: paying for general administrative, defense and social services, reducing the consumption of harmful goods and reducing income inequality. J. Harvey (1982) conveyed the purpose of taxation as achieving a fair distribution of wealth and income, compensation for social costs and benefits, and regulation of the economy. In his opinion, the economic development of the country should be regulated in order to develop important industries protect emerging industries, move factors of production from one industry to another, reduce unemployment, allocate resources, and stimulate the growth of national income. According to P.Njoku (2009), the goals of taxation include increasing income, reducing inequality in the economy, regulating and controlling the consumption of certain goods, curbing inflation, servicing public debt, planning and managing the economy, protecting new businesses, promoting exports and reducing imports. Financial institutions can participate in the prevention of inflation by obtaining tax deferrals.

**Analysis and results.** Simplification of taxation and accounting leads to a reduction in these costs for the taxpayer, as well as the corresponding administrative costs for the verification of taxpayers. In some cases, special tax regimes are aimed at reducing the possibility of tax evasion, which, among other things, can serve to more equitably distribute the tax burden.

Small business taxation in most countries differs in some way from the general business taxation regime. Tax measures vary depending on the goals pursued in the development of the tax regime and the conditions in which taxes are collected. Different countries differ in the traditions of paying taxes, the tax and legal literacy of taxpayers (and even, as the example of the economy of individual countries shows, the literacy of tax officials), the possibilities of control and coercion by tax administrations. The application of the same tax regime in different circumstances can lead to materially different results.

The legislation of a certain country may not provide for a special tax regime for small businesses at all, then in practice small businesses are provided with a number of advantages, including reduced tax rates, various investment incentives or tax holidays. In developed countries with fairly long tax traditions, the main goal of easing the tax regime for small businesses is to correct the allocation effects of taxation, which are manifested in relatively high costs for small businesses and a relatively high effective tax rate for them due to fewer opportunities to use the expenses allowed for tax deduction (such as depreciation). In such cases, reduced tax rates or additional depreciation options from accelerated depreciation to free write-offs apply. Reduced rates for enterprises with profits below the threshold or SMEs apply in Belgium, Canada, Finland, Japan, Luxembourg, the UK and the USA. Switzerland uses progressive taxation of corporate income. In Canada, Canadian-controlled private corporations receive a tax credit that reduces federal income tax by 16% if their annual taxable operating income does not exceed \$200,000.

As world experience shows, there are two main approaches to the taxation of small businesses:

- The first is to preserve all types of taxes for small businesses, but provides for a simplification of the procedure for their calculation (including simplified methods for determining the tax base and accounting methods) and collection (frequency, exemption from advance payments, etc.);

- The second approach involves an assessment based on indirect evidence of the potential income of taxpayers and the establishment of fixed payments to the budget, replacing one or more traditional taxes. The choice of a specific taxation regime and its characteristics is determined by the tasks that must be solved with the help of a special regime, as well as the conditions in which taxes are collected.

There are various options for establishing a simplified tax base for small businesses. Theoretically, one of the most attractive forms of taxation is the use of taxes on cash flows (cash-flow), which are characterized by simplicity of calculation, neutrality in relation to capital investments, and ease of administration.

Shome P., Schutte C. (1995) distinguishes three types of cash-flow taxes - R, RF and S, depending on the tax base.

In the case of an R-tax, the base is the net flow of real transactions in monetary terms, that is, the difference between sales proceeds and the cost of factors used in production. The RF-tax differs from the R-tax in that its base also includes the difference between the loans received and the debt repaid and the difference between the received and paid interest, that is, the net financial cash flow. S-tax is imposed on the net cash flows from the enterprise to shareholders, that is, the amount of dividends paid and shares repurchased less new share issues. If the only corporate tax is the cash-flow tax, then the difference between the RF-tax and the S-tax is that the base of the first includes the amount of the tax, and the second does not, due to the basic financial identity: taxes plus payments to shareholders are equal to the net cash flow funds.

The simplest to calculate and therefore especially attractive for small business taxation is the R-tax base. This tax base is efficient and similar to the base used for these purposes in other countries.

The cash flow base is relatively complex compared to a tax on revenue or some types of imputed taxes, because in calculating it, wages must be separated from profits. But it allows for the separation of the tax on payroll from taxes on capital income, which is important for determining the amount of social benefits that are determined on the basis of wages. At the same time, as shown by J. Stiglitz, such a tax does not have a distorting effect on investment decisions. Gross proceeds may also be taxed. In this case, it is easier to calculate the tax base, since it is not necessary to estimate the cost of factors. In addition, control is simplified: it is enough just to check the cost of manufactured products. The disadvantage of this tax is that it essentially represents a share in the price of production, that is, it distorts the costs of the producer.

The choice of tax base depends on what taxes are supposed to be replaced by the small business tax, as well as on administrative considerations. The cash flow base is best if the tax replaces the income tax. The use of gross receipts as a tax base is appropriate only when administrative considerations prevail.

When one of the priority goals of introducing a special regime for small businesses is to combat tax evasion, the application of a tax on gross receipts in the form of a minimum tax can help ensure a positive income level. The problem is that in this case, positive taxes are required even when the business incurs real economic losses and no tax liabilities should arise. Thus, there is discrimination against honest taxpayers who temporarily bear losses.

Consider options for taxation systems based on imputed income. The term "presumptive" means that there is a reasonable expectation that the taxpayer's normal income should be the same as the amount determined using the indirect method, or no less when imputation is used as a minimum tax. This concept includes many different ways to determine the tax base.

Implied methods can be divided into the following types:

**Disputable or undeniable.**

Under the contested method, a taxpayer who does not agree with the result of applying the method may appeal, certifying that his actual income, calculated according to the usual tax accounting rules, is less than calculated according to the imputed method. Disputable taxes are applied in cases where there is reason to believe that the taxpayer does not fully disclose his income in the declaration, and the possibilities of obtaining reliable information about the taxpayer's income are limited or significantly costly.

**Minimum or exceptional.**

The minimum is imputed taxation, which does not cancel the definition of tax liabilities under the usual rules, but prescribes that they be no less than those determined under the rule of imputation. Exceptional imputed taxation involves determining tax liabilities on the basis of imputation only, even though normal rules may lead to higher liabilities. Exceptional taxes are easier to administer and have an incentive effect in the short term due to their nature of a fixed payment that does not depend on the behavior of the taxpayer. However, the simplicity advantage of an exclusive imputed tax comes with a fairness disadvantage, since in this case taxpayers with the same imputed tax base must pay the same amounts, although their actual income may differ significantly. In addition, in the long run, effects come into play due to the fact that this tax is actually a tax on those factors that are used as indicators in determining imputed income.

**Mechanical (formal) or discretionary.**

Imputed methods differ in the degree of freedom afforded to tax authorities. Formal methods of imputation involve the determination of tax liabilities according to predetermined rules, which do not imply giving the tax authorities the freedom to establish tax liabilities. With discretionary methods, tax liabilities are largely at the discretion of the agent applying them. Discretionary methods are usually contestable, otherwise tax officials have considerable scope for arbitrariness. Formal methods can be either contestable or unquestionable.

Both formal and discretionary methods have significant drawbacks: the potential for corruption in the case of discretionary rules, the potential harshness of formal rules. The application of formal rules entails a reduction in administrative costs, but at the same time limits the ability to take into account specific circumstances, which can lead to excessive taxation.

Many imputed methods have been used in various countries for the purposes of taxing small businesses.

The taxation of gross proceeds provides for a minimum imputed tax, at which the taxable income of an enterprise cannot be less than a certain percentage of the gross proceeds of the enterprise. (France). This method is attractive due to the relative ease of administration and the possible increase in tax revenues. However, it has many disadvantages. Gross income tax:

- may result in the concealment of revenue and profit;
- repeatedly taxes some incomes when firms included in the same production chain are taxed (cascade effect);
- Can lead to significant inaccuracies depending on the industry, the degree of integration of a particular production, the type of product or service produced, since income is a significantly varying proportion of gross revenue. The classification of taxpayers by type of activity with a special percentage for each reduces the inaccuracy of imputation, but makes it more difficult to apply and requires significant resources to determine the boundaries of actual profit;

- Can lead to a decrease in production in those industries where it is applied and, consequently, to losses in public welfare.

Another method of imputation is the application of minimum taxes based on a fixed percentage of the enterprise's assets (Argentina, Colombia, Mexico, Venezuela). The tax base varies from gross assets to net assets, i.e. assets less debt. The economic rationale for an asset tax is that investors can expect *ex ante* to receive a certain rate of return on their assets. Such taxation is unfair, as *ex post* returns do not match those expected, and discrepancies can vary significantly between activities. A minimum tax on assets can discourage risky investments when the taxpayer does not have the ability to carry forward losses incurred as a result of the investment. This method of imputation is justified only when it helps to solve income tax administration problems that are difficult to deal with directly.

There are many methods of small businesses taxation, taking into account the characteristics of individual industries.

Italy applies a minimum imputed tax, differentiated by type of activity. Applying a minimum tax based on an individual's profession or occupation can lead to injustice for some taxpayers because it does not take into account income differences. To solve this problem, the division of taxpayers in each industry under consideration into two or three classes is used, based on the flat tax turnover within each group or on the basis of the type or amount of capital equipment used in the business.

Taxation under the contract method (*forfait*), widely used in France, provides for the conclusion between the tax authorities and taxpayers whose annual turnover is below a certain value, a preliminary agreement to establish tax liabilities on estimated rather than actual income. The valuation methods for determining the "*forfait*" amounts are based on statistical analysis and on a detailed classification of industries, which requires a large amount of complex work, high qualification of tax inspectors and effective control of higher authorities over their activities. For these reasons, the contract method may not be acceptable for many countries, including Uzbekistan (Zaynalov, D. (2017)).

Some countries tax income from specific activities on a turnover basis, with imputed deductions based on proportions common in the industry. This method is more correct than the gross revenue method, but its application requires large research costs.

Taxation according to the Standard (Standart Assessment Guides) (for example, *tachshiv*, used in Israel, later replaced by *tadrihim*), and similar methods are used in several countries (except Israel, similar methods are used by Spain and Turkey). These are purely imputed taxes calculated on the basis of indirect evidence. The imputed income is set depending on the type of activity of a small enterprise and on the presence at its disposal of the factors necessary for the activity that are difficult to hide during verification (the number of seats in a restaurant, chairs in a hairdresser, etc.). "*Tachshiv*" includes elements of an agreement between taxpayers and tax authorities, but an agreement on "*tachshiv*" in general, which is negotiated with industry representatives, and not its application to a particular payer.

The use of such methods can be effective in taxing small businesses in certain industries, but its application requires a significant amount of preliminary research in order to isolate the factors that determine the normal income in specific industries and determine the coefficients for each factor.

There are a number of problems with taxation according to the standard. First, those taxpayers whose income exceeds the average for a given type of activity may deliberately not keep records sufficient for taxation on the basis of declarations, thus falling under imputed taxation. In order to solve this problem, the taxpayers to whom "standard" taxation is applicable must be established on the basis of a precise criterion, preferably on the basis of a

turnover criterion. An important issue when introducing taxation according to the standard is the question of whether it is introduced as mandatory or at the choice of the payer. From the point of view of V. Thuronyi, "the preferred solution is to establish mandatory taxation according to the standard for payers with a turnover below the threshold, but with permission for the taxpayer to make an irrevocable choice to use normal accounting rules instead".

Another problem with the use of such taxes is that "relying on certain factors in estimating income can result in the tax being transformed into a tax on those factors rather than a general income tax, thus distorting the optimal use of factors in production, and other business decisions. This consideration can be largely attributed to almost all imputed methods.

When taxing agriculture, the usual approach is to impute income on the basis of land area and quality. Certain activities may be excluded from imputed taxation, and large enterprises may be taxed on the basis of actual income. For example, in France, farmers with a turnover of up to 500,000 francs are subject to imputation taxation. Taxable income from agricultural activities is determined according to the area of cultivated land, crop type and region. For each region, the average profit from each type of crop is determined annually by a committee consisting of representatives of the tax administration and farmers.

In developing countries, small businesses and tax authorities face additional challenges, such as less legal literacy and weak tax administration. In this case, the use of ordinary declarative accounting systems by small businesses generates such significant costs of law-abiding that it stimulates the withdrawal of firms into shadow activities. In these cases, the judicious use of imputed methods "can broaden the tax base by increasing the number of taxpayers in their payments and can reduce tax evasion - all at relatively low administrative costs." In cases where there is a danger of arbitrariness of the tax authorities, the right to choose between imputed taxation and the traditional system of tax payment is established.

In Chile, a taxpayer whose income does not exceed 3,000 tax units per year (on average over the past three years) has the right to choose a special regime. Under the special regime, distributed income is taxed upon distribution, and withheld income upon termination of activity or at the end of the special regime. Income accrued or actually received is considered part of the share capital until it is withdrawn or distributed. Withdrawn or distributed income is subject to FCT (First Category Tax, Chile's corporate income tax) at the enterprise level, and advance payments must be made when taxing these incomes. Small traders operating on the streets pay a flat tax annually (half a monthly tax unit) along with a municipal license fee. Newspaper sellers are subject to an annual tax equal to 0.5% of their sales.

Brazil applies a system of small enterprises taxation with gross income as a tax base and differentiated rates depending on the annual gross income. Tax rates vary from 3% to 7% of the company's gross income. The criterion for recognizing an enterprise as small is also gross income. At the same time, an individual enterprise providing services (for example, washing cars) may not be registered with the Central Cadastral Department of Taxpayers and have the status of an informal enterprise.

Restrictions for recognizing enterprises as small or micro, in addition to income, include the form of ownership, type of activity (taxation under the system of small enterprises is not allowed for credit and financial, insurance, rental, investment, security; enterprises engaged in operations with securities, currency, real estate), participation in the authorized capital of this enterprise of certain persons (foreign citizens and legal entities, enterprises with the participation of state institutions), participation of the enterprise itself in the authorized capital of other legal entities, in the implementation of export-import transactions, the type of services provided (it is unacceptable in the system to provide services broker, singer, sales representative, composer, therapist, dentist, nurse, engineer, accountant, programmer, lawyer, psychologist, teacher, etc.), the presence of receivables for mandatory payments, social

insurance, excess of the total income of the owner from this enterprise and participation in other enterprises of a certain extent. The enterprise has the right to choose the generally accepted taxation rate, that is, taxation under the system for small enterprises is not mandatory.

**Conclusion.** Summarizing the international experience of taxation of small businesses and taking into account the theoretical foundations of the construction of tax systems, it can be argued that a reasonable system of taxation of small businesses should be based on the following principles

- Small business should be considered as a social phenomenon that provides employment and self-employment, the implementation of entrepreneurial initiative and innovation, and other effects, and not as one of the main fillers of the budget;
- Rules for small business taxation should be stable and accessible so that each entrepreneur clearly knows how much and when he must pay. The process of tax withdrawal should be convenient, first of all, for the business itself, and not for the state. Tax reporting and tax accounting should be simplified as much as possible:
- Determining the list of basic taxes for small businesses should be carried out at the state level. At the same time, taking into account the local specifics of the main part of small businesses, the regions should be given maximum opportunities to regulate the parameters of the small business taxation system.

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