

RESEARCH ON SME TAXATION FIELD

2013

Summary of the meetings
organized in the regions of RA
by the EBRD Business Support Office



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The EBRD Business Support Office experts jointly with the representatives of the regional offices of SME DNC organized regional meetings in the regions of RA with SME focus groups in June-July 2013.

The meetings resulted in a research on the impact of taxation rates regulated by the [RA law “On Turnover Tax”](#) (enacted on January 1, 2013) on SMEs.

The research was carried out on the basis of anonymous questionnaires filled in by the SMEs, as well as based on the outcomes of face- to- face discussions, in course of which other issues outside the scope of the RA law “On Turnover Tax” had been revealed.

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Introduction

In April 2012, during the regular meeting of the SME Development Council the issues related to the SME tax system complexity and its ineffectiveness were discussed. A draft law on the Turnover Tax (a new type of tax in the RA) was developed by the experts representing the Secretariat of the SME Development Council and the EBRD Business Support Office. In September 2012, the RA State Revenue Committee by the Government together with the Ministry of Finance of the RA introduced another draft law on the Turnover Tax, which came into force on January 1, 2013 after a series of discussions. Nowadays apart from the patent fees anticipated for certain business activities, the above-mentioned tax is the only one which stipulates some tax privileges for the SME units.

As a result of a series of meetings with SME units in the regions of Armenia a research on the implementation of the new Turnover Tax in the first half of 2013 was carried out. The general outcome of the research is as follows:

SME units are satisfied with the idea of the new tax, as they are not obliged to do a complex accounting anymore, as well as do not face difficulties in obtaining unfounded and undocumented purchases. Instead, they develop simple quarterly reports, make quarterly estimated tax payments and perform a simple tax calculation.

However, the implementation of the Turnover Tax in practice proved the opposite. The details are shown below.

Definition of Small and Medium Entrepreneurship

In compliance with the RA law on “Small and Medium Entrepreneurship State Support”, the SME units are classified as micro, small and medium entrepreneurs:

- The SME units engaging up to **10 employees** and with up to **100 mln. AMD** annual revenue are considered MICRO-sized;
- The SME units engaging up to **50 employees** and with up to **500 mln. AMD** annual revenue, are considered SMALL-sized;
- The SME units engaging up to **250 employees** and with up to **1500 mln. AMD** annual revenue, are considered MEDIUM-sized.

Meanwhile, in compliance with the Tax legislation of the RA, the SME units are classified as the entities imposed by the Turnover Tax and with up to **58.35 mln. AMD** annual revenue, and the tax payers operating in the general tax system. However, the micro, small and medium entrepreneurs are not mentioned in the RA tax legislation and there are no privileges for the SME units, stipulated by the latter. This approach is a matter of confusion for the state authorities and the business entities, as well as for researchers, etc.

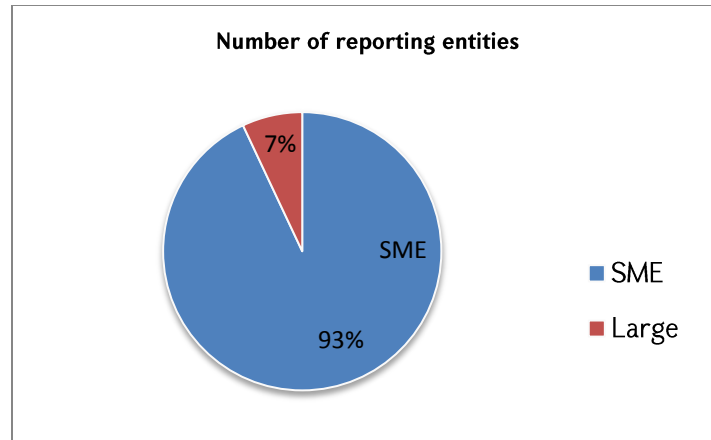
Therefore, *in order to prevent further confusion and to have more flexible tax system it is necessary to develop one common classification criteria for the SME units instead of the existing two ones.*

In the framework of this research, micro-sized entrepreneur (tax payers or business entities) is the one who meets the criteria stipulated by the RA law on “Small and Medium Entrepreneurship State Support” and has up to 10 employees and up to 100 mln. AMD annual revenue.

SME units and the taxation system of the RA

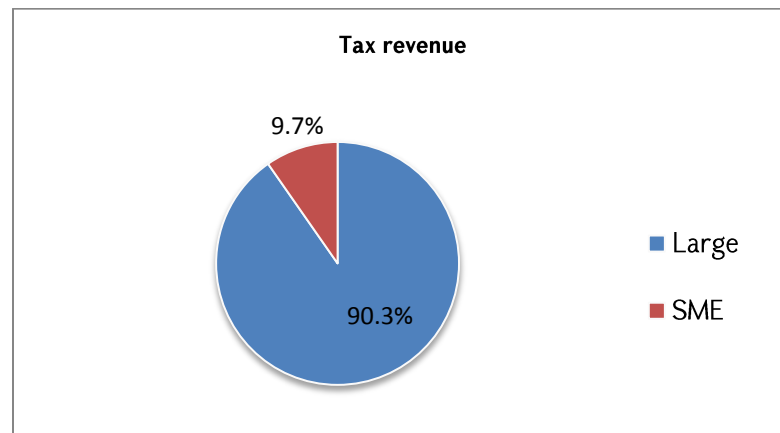
According to the official information provided by the State Revenue Committee on the entities who develop online reports, the following becomes clear:

As of the first quarter of 2013, there are **78.787** taxpayers who prepare reports. Meantime, according to another official information, the overall number of SME units is **73.803** (**93%** of all the reporting entities).

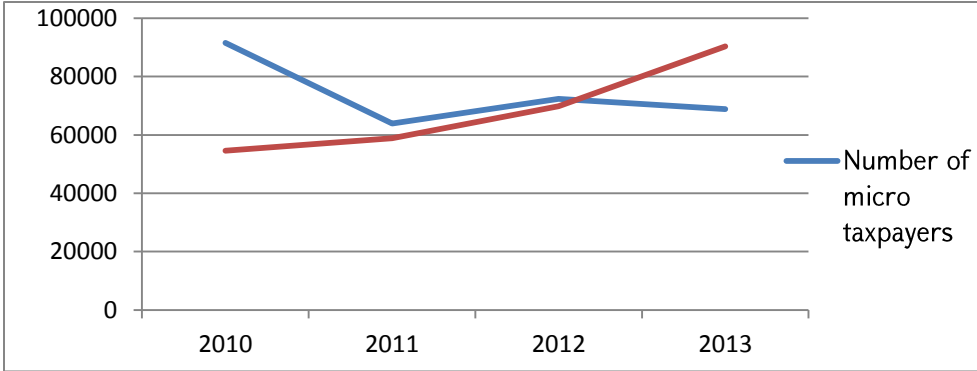


As of the first quarter of 2013, there are 68.873 **micro taxpayers**. Their annual revenue is up to **100 mln AMD** and the average number of their payroll employees is **up to 10**.

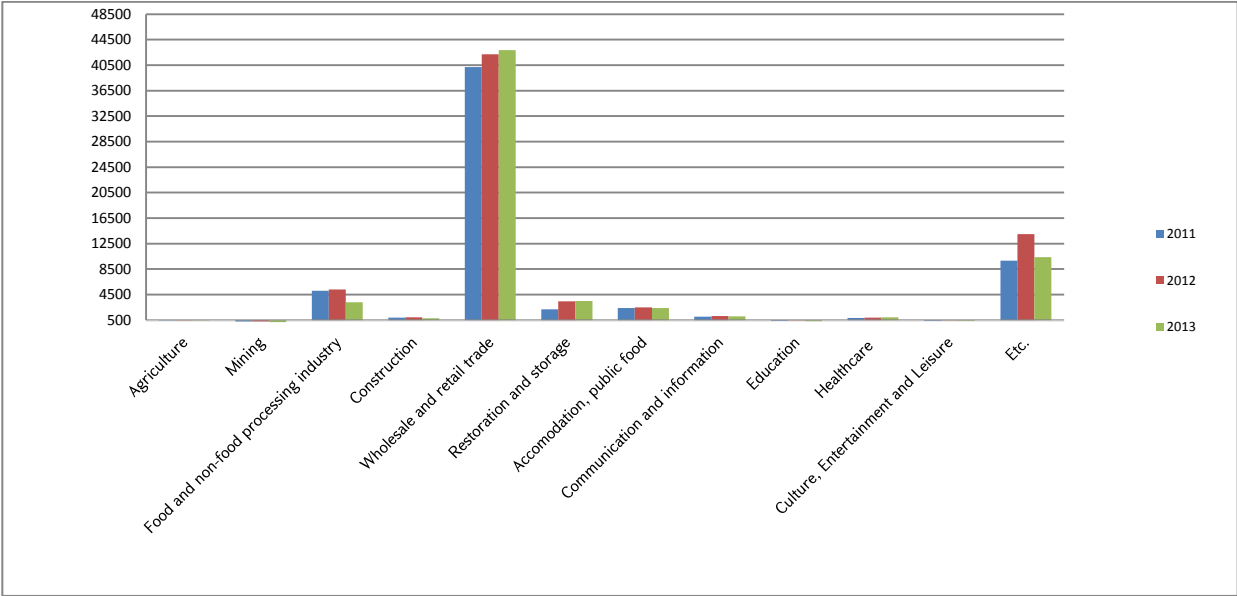
As of the first quarter of 2013, the volume of taxes paid by the micro-sized units is around 45.2 billion AMD. According to the Ministry of Finance of the RA, the above-mentioned number makes 9, 7% of the overall tax revenue (467, 7 billion).



The Charter below reflects the quantitative dynamics of the micro taxpayers in comparison with the taxes paid by the latter during the recent years.

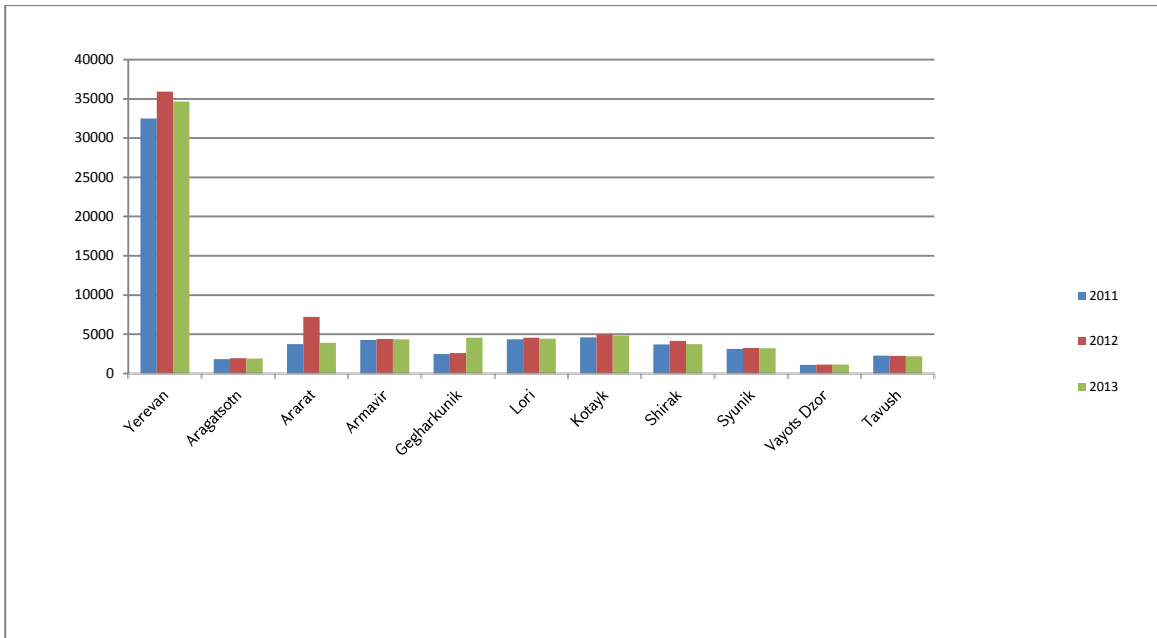


The Charter below reflects the quantitative dominance of the trading sphere over the others.



The agricultural sector includes solely those taxpayers who are involved in the recycling of agricultural products, as the producers of agricultural products are not registered in tax authorities.

The taxpayers who are involved in trade, make around 62% of micro taxpayers. The allocation of micro taxpayers in regions is as follows:



Around 50 % of all the **micro taxpayers** operate in Yerevan.

The impact of the Turnover Tax: relevant issues and concerns

As it is mentioned in the Introduction part of this research, the SME units are satisfied by the idea of the Turnover tax. During face-to face meetings the SME units mentioned that this type of the tax allows avoiding the process of complex accounting, as well as avoiding numerous tax inspections and estimations. Due to the Turnover tax SME units develop simple quarterly reports and making quarterly estimated tax payments.

Initially, the idea of Turnover tax was based on the following simple principle: those taxpayers, who implement accurate revenue accounting, should not face any difficulties arisen as a result of tax supervision.

Thus, a simple formula is applied:

Turnover Tax = Revenue x Rate

However, the text of the law is not written clearly, which led to misreading and misinterpretation. For instance, it was stipulated by Article 3 of the RA law on “Value Added Tax” that if the founders or participants of organizations are physical entities and in parallel hold 20% or more of shares in another organization, the given two organizations are considered VAT payers, irrespective of their turnover.

This term regarding introduction of Turnover tax was moved from RA law on “Value Added Tax” and incorporated in Article 4 of the RA law on “Turnover Tax” with a different wording. This wording caused numerous disagreements between the State Revenue Committee of the RA and the business entities.

As a result, nowadays there are a number of taxpayers who considered themselves as VAT payers, however according to the State Revenue Committee of Armenia they should have been considered turnover tax payers, which means now that they have to pay big fines and penalties. Tax payers complained that during the introduction stage of Turnover tax the State Revenue Committee never mentioned anything regarding this term either in the justification part of the law or during the meetings with taxpayers.

Turnover Tax Rate

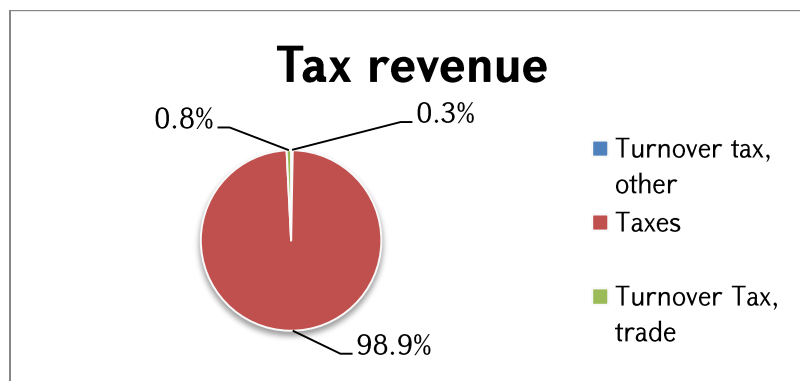
As a result of regional visits it was revealed that by the introduction of Turnover tax , the latter increased by 0.3 % on average, however the turnover tax rate of retailers increased by approximately 1 %, which is equal to a **45% increase** of tax burden. If in 2012 taxpayer’s estimated tax was 2 to 2.4% of total turnover, now according to the operating law, it constitutes 3.5%.

In November 2012, at the meeting of SME Development Council a reasonable answer was not provided to the voiced issue regarding 3.5% tax rate increase at the stage of draft law, as a result of which taxpayers do not understand where this tax rate comes from.

However, according to the State Revenue Committee bulletin of 2011, taxpayers having up to 58.53million turnover paid 2.4% tax of the total turnover.

As a result of regional meetings the anonymous questionnaires filled in by focus groups testify to the fact that sales taxpayers paid 2-2.4 % of total turnover.

According to results of the first half of the 2013, 5.1 billion drams were debited to the state budget in line with the turnover tax., 3.7 billion drams out of which was accumulated from sales turnover tax. During the same period, 0.3 % out of 467,7 billion of total tax revenues constituted the turnover tax of other activities and 0.8% of the total budget revenues was the sales turnover tax.



As of the first quarter, there are 50144 taxpayers paying the turnover tax, 32000 out of them are sales taxpayers.

All the above mentioned directly resulted in the decrease of business entities enrolled in this sphere. As a result, in comparison with the same period of the previous year, in 2013 the number of retailers decreased by 18%.

The concerns related to the activities of taxing authorities voiced by the taxpayers of the RA regions

1. Forced tax collection actions

1.1 Each month (from 20th to 30th) the employees of tax inspectorates make visits to taxpayers, call them or even invite the latter to tax inspectorates without any reason in order to share their stories on tax collection plan with taxpayers. During these meetings representatives of tax inspectorates demand or even ask taxpayers to pay a certain part of the taxes by the end of the month, otherwise they would be fired. Moreover, the same refers to the entities who pay the Turnover tax, regardless of the fact that the tax should be calculated and paid on a QUARTERLY basis.

1.2 There are numerous cases in regions when in reality the amount of money due to be paid by the micro taxpayer differs from the amount of money demanded by tax inspector. As a result, the taxpayer pays as much as demanded; in future the taxpayer makes a calculation which corresponds to the taxes paid. This calculation essentially differs from taxpayer's real turnover.

1.3 There are numerous cases when taxpayers are "invited" to tax inspectorates and are psychologically pressed to make a promise that they would pay the amount of money required by the inspectors.

2. "Supervision procedures" for maternity benefits

2.1. In order to provide maternity benefit to the employee, the employers develop relevant package of documents and submit it to their territorial tax inspectorate, as it is stipulate by law. Almost in all cases employees of the legal affairs department of the tax inspectorate submit the case to the Investigation department of State Revenue Committee in order to check the validity of the case. The investigator invites both the employer and the accountant, as well as the employee who was provided maternity benefit regardless to how far from Yerevan the latter live. All of them should come to the Investigation department, should write explanations, etc. Then the same case is submitted to the Prosecutor's Office. Afterwards, the investigator of regional police launches the same activities. There are even cases when the regional investigator simply "invades" the apartment of the new-born and his/her mommy late in the evening in order to check the validity of the case and to receive explanations.

2.2. In numerous cases the investigator of State Revenue Committee persuades or even intimidates the employer to take back the submitted case; otherwise he would launch the inspection procedure.

3. Checks of deployment of cash control machines

- 3.1. It has already become mandatory for the taxpayers to submit a report regarding the deployment of cash control machines once a year.
- 3.2. In regions tax inspectors do not buy anything in order to record a violation. They prepare relevant reports on deployment of cash control machines based on “street” conversations.

4. Provision of official documents and admission of reports

- 4.1. If the taxpayer has any ongoing tax liability and he needs to get any official document (for example, a document to be submitted to the bank) from the tax authorities, the latter, led by internal instructions, refuse to provide any document unless the tax is paid.
- 4.2. The same happens, when the taxpayer applies to tax inspectorate to approve the sample of the signature required for opening a bank account, or to register or unregister a cash control machine. To perform the above-mentioned actions, the taxpayer should carry out all the tax liabilities, in order the employee of tax service center addresses the concerns of the taxpayer.