

RESEARCH ON SME TAXATION FIELD 2016

SME TAX
REVENUES

GEOGRAPHIC
DISTRIBUTION
OF SMES

ACTIVE
TAXPAYERS

SHARE
OF SMES
IN GDP



EBRD BUSINESS
SUPPORT OFFICE

YEREVAN, 2017

This research has been prepared by the EBRD Business Support Office (BSO) consultants based on official data and public information acquired from state bodies.

As a benchmark, the BSO set the research carried out back in 2013, which was a combination and computation of the official data and anonymous questionnaire-based survey carried out among SME sector representatives.

The BSO set a goal to regularly carry out similar researches during the following years and on.

The main focus of this research is the illustration of taxation field for micro businesses, which are the major part of SMEs, and their portion in the tax revenues of Armenia.

For the research period high importance was paid to the changes in the tax system relating to SMEs and the positioning and dynamic of SME sector in sectorial and regional localization scheme.



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WHO THE SMALL AND MEDIUM ENTERPRISES (SMEs) ARE

In different researches and contributions definition of small and medium enterprises (SMEs) varies and mainly hinge on the taxation regime they adhere to. As such, there is a misconception amongst the market players that SMEs are equivalent to the turnover tax payers, which in its turn leads to serious misinterpretation of the term both for public authorities and business representatives. Meanwhile, the only legal act that sets forth classification criteria for SMEs is the RA Law “On state support to small and medium enterprises”. The latter distinguishes Micro, Small and Medium enterprises in accordance with the *number of employees* and *annual income of the previous fiscal year*:

MICRO	SMALL	MEDIUM
Up to 10 employees	Up to 50 employees	Up to 250 employees
The previous fiscal year’s income up to 100 million AMD or the balance value of the assets by the end of the year is less than 100 million AMD .	The previous fiscal year’s income up to 500 million AMD or the balance value of the assets by the end of the year is less than 500 million AMD .	The previous fiscal year’s income up to 1000 million AMD or the balance value of the assets by the end of the year is less than 1000 million AMD .

Hence, this research will operate in accordance with the above-mentioned classification and apply data obtained from the Armenian Statistical Office, as well as data provided by the RA Ministry of Finance and RA Ministry of Economic Development and Investments.

SME TAXPAYERS

Small and medium enterprises in Armenia take on a wide range of legislative forms registering as sole proprietors, limited liability company (LLC), closed or opened joint stock company (CJSC or OJSC), etc. Depending on the SME field of operation, structure and annual turnover the enterprises fall under one of the following tax regimes: turnover tax, VAT tax along with tax on

retained earnings, income tax, fixed or privileged payments. At the same time, several taxation schemes have been introduced in recent years targeting specific groups of taxpayers:

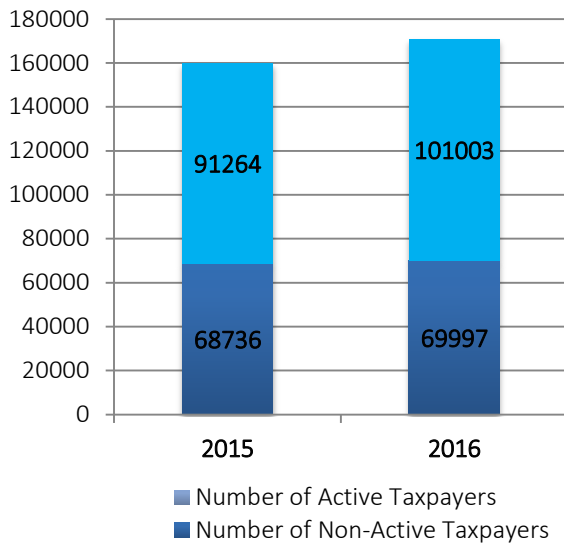
- the RA Law on “State support to the IT Sector” implying exemption of all the performance related taxes and lowered income tax of 10% for start-ups in the IT sector for 5 years;
- the amendments in the RA Law on “Taxes and Taxation” ensuring exemption of all but income tax for the family entrepreneurships;
- the RA Law “On taxation privileges to self-employed people” implying exemption of all the performance related taxes in case individuals and/or individual entrepreneurs are engaged in the specified activity independently, e.g. are self-employed.

In order to derive an accurate analysis of the SMEs in the taxation system and assess comprehensively the role of SME taxpayers in the general tax revenues it is essential to distinguish *active taxpayers vs. taxpayers registered in the RA State Registry*. For the purposes of the current research, active taxpayers are defined as taxpayers (sole proprietor, LLC, CJSC and other commercial organization), who have submitted reports to the tax authorities in the two preceding quarters. As opposed to the active taxpayers, the overall number of taxpayers registered in the RA State Registry differs considerably given the fact that in all the cases when an entrepreneur suspends his/her business activities by means of submitting a relevant application, it continues to be considered registered in the State Registry as an existing taxpayer. This was the reason that on December 16, 2016 the RA Law “On liquidating companies and removing individual entrepreneurs from state registry that fail to submit tax reporting by January 1, 2013” was adopted, as a result of which 48.000 companies will be liquidated by January 1, 2018.

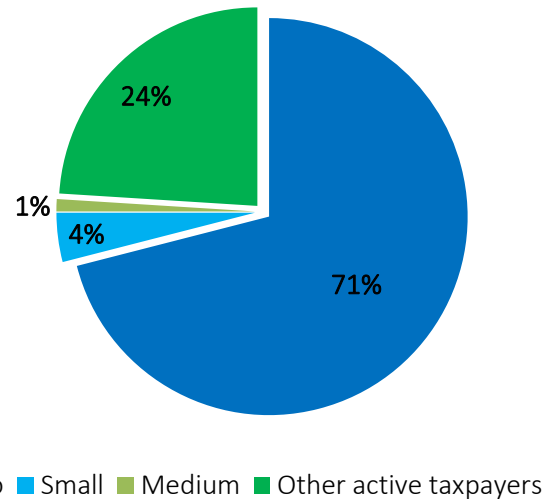
The importance to distinguish the active taxpayers from the registered ones is emphasized once referring to the numbers at hand. As such, according to the State Registry at the end of 2016 there were about 171 000 registered taxpayer entities, out of which only 101 003 (or 59%) comprise the active taxpayers. At the same time, as shown in Graph 1, the number of active

taxpayers in 2016 has increased by 9 739 compared to the previous year. Such a big discrepancy between active and registered taxpayers lies in the complicated liquidation process which forces businesses to freeze their activities applying suspension rather than closure.

Graph 1. Number of active and registered taxpayers



Graph 2. Number of SMEs among active taxpayers, 2016



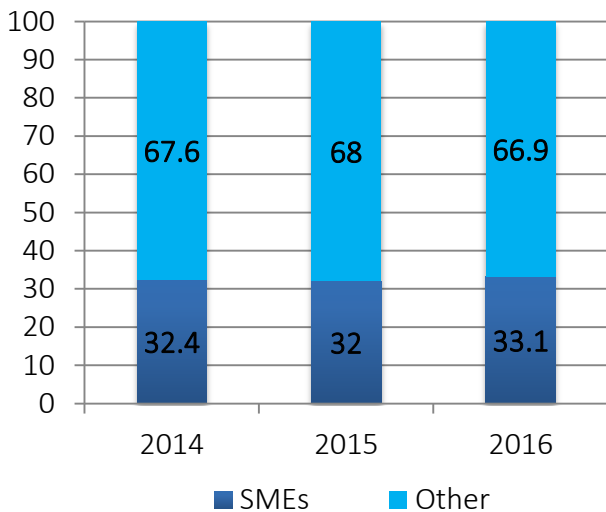
The latter practice, thus, has led to the increase of the total number of inactive taxpayers and distorted the overall statistics. It can be traced from graph 2 that as of 2016, SMEs account for **76%** of the overall active taxpayers comprising **77 163** entities, out of which **72 188** are represented by micro businesses (or **71%** of active taxpayers), **4030** are small businesses (**4%** of active taxpayers), **945** – medium businesses (**1%** of active taxpayers).

SMEs account for 76% of Active Taxpayers in Armenia.

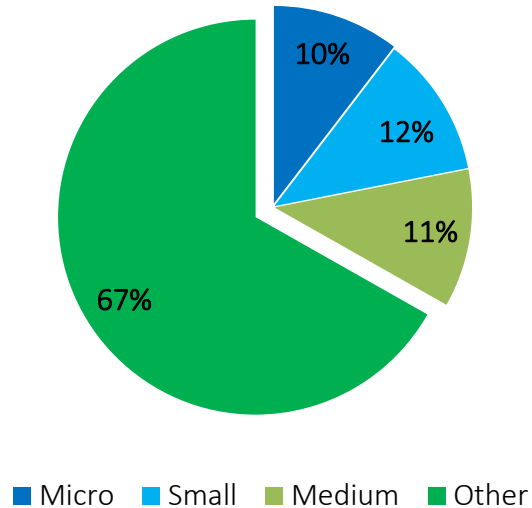
SMEs TURNOVER AND JOBS

Being the backbone of the Armenian economy, SME turnover has comprised around third of Armenia's GDP throughout the past 3 years. In the year of 2016, GDP of Armenia amounted to 5 067.9 bln. AMD, while turnover generated by the SMEs in the same year was 1 681.7 bln. AMD, or **33.1% of Armenia's GDP**. At the same time, as shown in Graph 4, micro-sized businesses accounted for **10%** of the country's GDP (or **528bln. AMD**), small-sized businesses – for **12%** (or **579 bln. AMD**), and medium-sized businesses – for **11%** (or **572 bln. AMD**).

Graph 3. Share of SMEs in GDP, in %



Graph 4. Contribution of SMEs in generation of GDP in 2016, in %



**Overall SMEs provide an average of
33% of the country's GDP**

Having a big share in the GDP formation, in 2016 SMEs also provided **238 311 jobs** which comprises **64.3% of total jobs** in the private sector for the given year, where **72 188 micro** businesses provide **116 722 jobs** (or **31.5% of total number** of employees in the private sector), **4030 small** businesses create **60 273 work places** (or **16.2% of total number** of employees in the

private sector), **945 medium** businesses open up **61 316 work places** (or **16.9% of total number** of employees in the private sector).

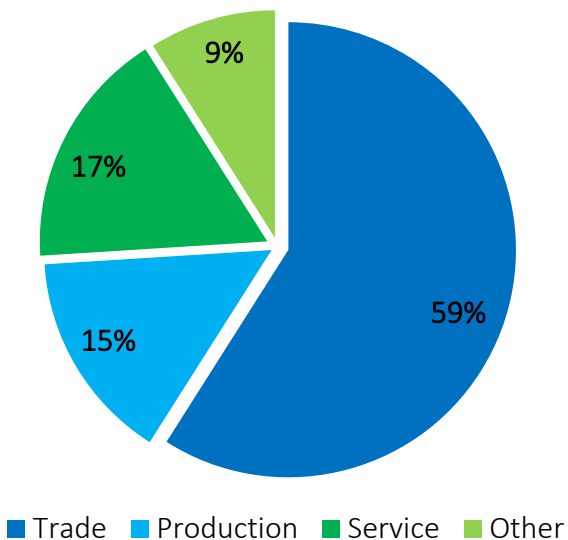
Each micro-sized enterprise provides employment for an average of 2 people, having on average turnover of around 7.3 million AMD. Meanwhile, each small-sized enterprise provides a workplace for an average of 15 people and generate on average 143.6 million AMD. Last, but not the least, each medium-sized enterprise creates on average 65 workplaces and has an average annual turnover of 607.6 million AMD.

Table 1. Employee / Turnover indicators for SMEs, 2016		
Type of SME	Actual (average)	In accordance with SME definition
	Number of employees	
Micro	2	10
Small	15	50
Medium	65	150
	Annual turnover (mln. AMD)	
Micro	7.3	100
Small	143.6	500
Medium	607.6	1500

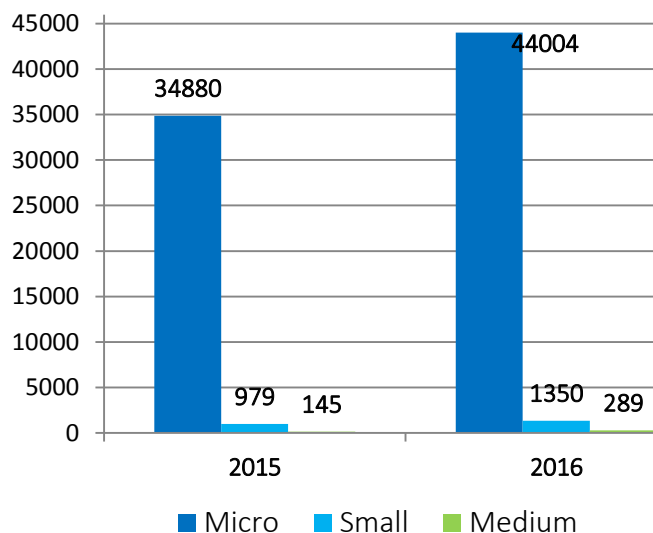
As articulated in Table 1, there are huge discrepancies between the actual numbers and legislative thresholds defining the size of the SME. In this context, it should be mentioned, that compared to 2015, the discrepancies have shortened when it comes to the annual turnover: back in 2015, each micro business generated on average 6.2 mln. AMD, small business – 109.3 mln. AMD, medium business – 571.3 mln. AMD. Nevertheless, when it comes to the number of employees the discrepancy has increased: back in 2015, each micro business provided on average 2 workplaces, small business – 22 workplaces, and medium business – 106 workplaces.

In 2016, SMEs provided 64.3% of the overall labor market.

Graph 5. SME structural organization in accordance with activity area in 2016



Graph 6. SME structural organization in the trade sector in 2015 and 2016



Derivation of the full picture on SMEs operation and successful performance requires a closer look at the structural organization of the latter according to the activity areas. As can be traced from Graph 5, structural organization of the SMEs in Armenia is not diversified with the main area of SMEs activities being retail and wholesale trade. The number of SMEs registered in the trade sector in 2016 amounts to **45 643 entities**, with **96.4%** being concentrated amongst **micro-sized** enterprises. At the same time, the given patterns are consistent for the past several years with the number of SMEs in the trade sector steadily growing irrespective of the enterprise size. As shown in Graph 6, the number of micro businesses in the trade sector has grown by **9124 (or 26.1%)**, small businesses – by **371 (or 37.8%)**, medium businesses – by **144 (or 99.3%)**. On the other hand, it would be useful to have a more detailed analysis on the types of activities SMEs are engaged in. Table 2 compiles the types of activities micro, small and medium-sized enterprises are engaged in specifying on one hand, their shares in the given activities and on the

other hand, their shares in the total number of the enterprises. As such, the following top activities have been identified:

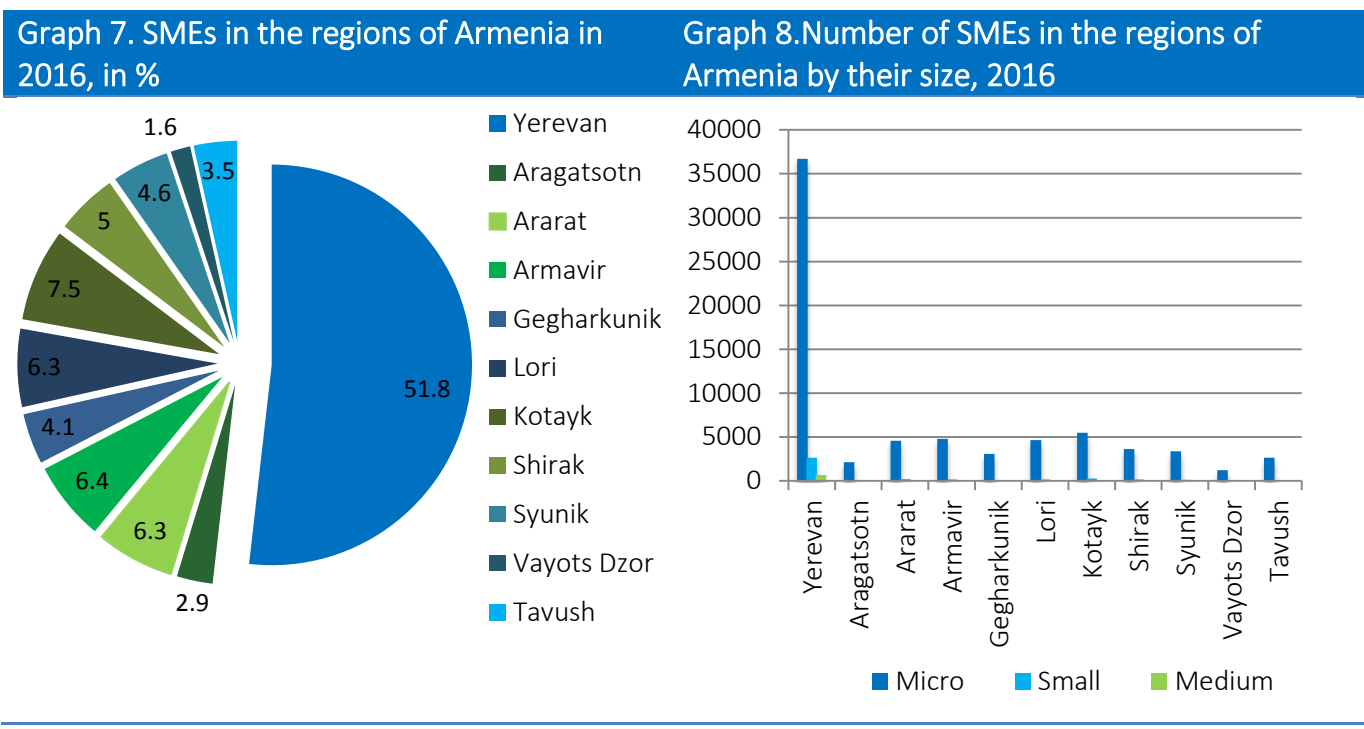
- 61% of micro-sized enterprises are concentrated in wholesale and retail trade, 8.9% – in manufacturing and 8.6% – in other service activities;
- 33.5% of small-sized enterprises are concentrated in wholesale and retail trade, 12.4% – in manufacturing and 8.3% – in construction;
- 30.6% of medium-sized enterprises are concentrated in wholesale and retail trade, 14.3% - in manufacturing and 9.2% – in construction.

	Micro (number)		Small (number)		Medium (number)	
	Share in total number of micro businesses	Share in the given type of activity	Share in total number of small businesses	Share in the given type of activity	Share in total number of medium businesses	Share in the given sector
Activities of foreign companies	6		0		0	
	0.008%	100%	0%	0%	0%	0%
Activities of households	7		2		0	
	0.009%	77.7%	0.05%	22.3%	0%	0%
Public administration	35		1		0	
	0.05%	97.2%	0.02%	2.8%	0%	0%
Water supply, sewerage, waste management	51		11		6	
	0.07%	75%	0.27%	16.2%	0.63%	8.8%
Electricity, gas, steam and air conditioning supply	121		138		9	
	0.16%	45.1%	3.42%	51.5%	0.95%	3.4%
Agriculture, hunting, forestry and fishing	266		36		14	
	0.37%	84.2%	0.89%	11.4%	1.48%	4.4%
Mining and quarrying	294		33		6	
	0.4%	88.3%	0.82%	9.9%	0.63%	1.8%

Education	358		83		17	
	0.5%	78.1%	2.05%	18.1%	1.8%	3.8%
Arts, entertainment and recreation	508		30		6	
	0.7%	93.4%	0.75%	5.5%	0.63%	1.1%
Financial and insurance activities	731		48		18	
	1%	91.7%	1.2%	6%	1.9%	2.3%
Transportation and warehouse activities	651		185		41	
	0.9%	74.2%	4.6%	21%	4.3%	4.8%
Public health and social work activities	767		154		123	
	1%	73.5%	3.8%	14.7%	13%	11.8%
Construction	998		333		87	
	1.4%	70.4%	8.3%	23.5%	9.2%	6.1%
Real estate activities	1576		110		14	
	2.2%	92.7%	2.7%	6.5%	1.5%	0.8%
IT and communication	1496		200		46	
	2.1%	85.9%	5%	11.5%	4.9%	2.6%
Administrative and support service activities	1589		131		45	
	2.2%	90%	3.2%	7.4%	4.8%	2.6%
Accommodation and catering services	2883		314		43	
	4%	89%	7.8%	9.7%	4.6%	1.3%
Professional and scientific activities	3137		216		31	
	4.4%	92.7%	5.4%	6.4%	3.3%	0.9%
Other service activities	6242		155		15	
	8.6%	97.3%	3.8%	2.4%	1.6%	0.3%
Manufacturing	6468		500		135	
	8.9%	91%	12.4%	7%	14.3%	2%

Wholesale and retail trade	44 004		1350		289	
	61%	96.4%	33.5%	3 %	30.6%	0.6%

The vast majority of the SMEs, **51.8%**, are located in Yerevan and mainly, the adjacent regions of **Kotayk – 7.5%, Ararat – 6.3%, Armavir – 6.4%** (see Graph 7). The number of SMEs operating in Yerevan amounts to 40 007 entities, out of which 36 678 are micro-sized, 2642 are small-sized and 687 are medium-sized businesses, with the close second being Kotayk – 5 799 enterprises, out of which 5478 are micro businesses, 261 – small businesses and 60 – medium businesses (see Graph 8).



At the same time it should be noted, that the situation of SMEs non-diversified geographic distribution has been persistent over the past 4 years. The latter should also be deemed in the context of the size of the region as proxy for its potential. As can be traced from Table 3, there is high unfulfilled potential in the regions of:

- Aragatsotn covering 4.4% of population has 2.9% of SMEs
- Gegharkunik covering 7.8% of population has 4.1% of SMEs
- Shirak covering 8.3% of population has 5% of SMEs

- Ararat covering 8.6% of population has 6.3% of SMEs
- Armavir covering 8.8% of population has 6.4% of SMEs

Whereas Yerevan covering 35.1% of population has accumulated 51.8% of the SMEs in Armenia.

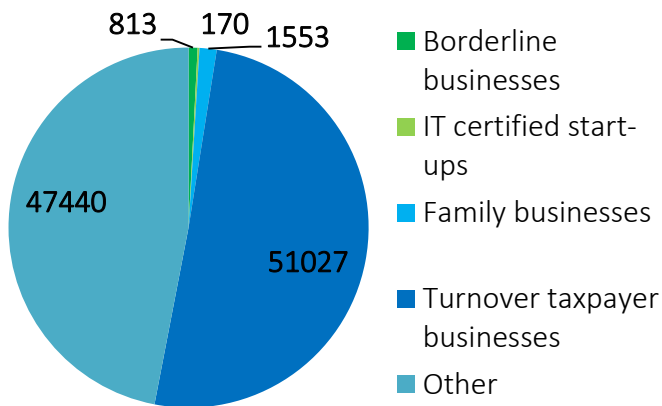
Table 3. Comparative statistics of region's size and its SME concentration		
	Share in the total population of Armenia	Share of SMEs in the given region
Vayots Dzor	1.7%	1.6%
Tavush	4.3%	3.5%
Aragatsotn	4.4%	2.9%
Syunik	4.7%	4.6%
Lori	7.8%	6.3%
Gegharkunik	7.8%	4.1%
Shirak	8.3%	5%
Kotayk	8.4%	7.5%
Ararat	8.6%	6.3%
Armavir	8.8%	6.4%
Yerevan	35.1%	51.8%

In 2016, 59% of SMEs were engaged in trade, 51.8% operate in Yerevan.

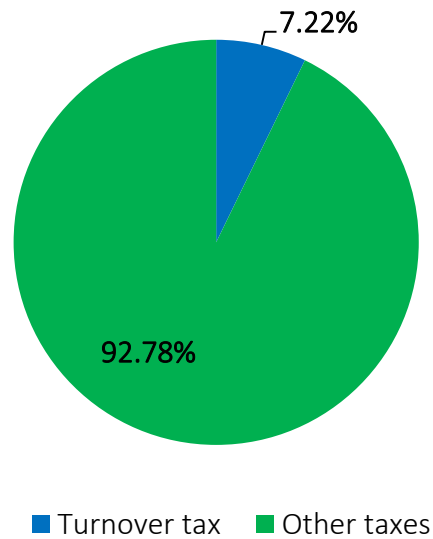
SMEs IN TAXATION

In line with the new regulations on the IT start-ups, family and borderline businesses, in 2016 2536 entities falling in one of those categories received exemption of the taxes and have been working under the privileged status, overall covering 2.51% of all SMEs. At the same time, as can be spotted in the Graph 9, turnover tax payers totaling 51 027 entities comprise 50.5% of the operating SMEs.

Graph 9. Distribution of SMEs in accordance with tax regime, 2016



Graph 10. Taxes paid by SMEs in 2016



In 2016, turnover tax paid by SMEs amounted to **15.48 bln. AMD**, which is **7.22%** of their paid taxes. The proportion of turnover tax in the cumulative amount of tax incomes for 2016 covers **1.43%**, in 2015 – **1.15%**. Even though the proportion is still insignificant, it should be mentioned that in 2015 the turnover tax collection made up **11.9 bln. AMD**, implying that in 2016 the turnover tax incomes have **increase by 30%** (or 3.58 bln. AMD). The reasons behind the given increase can be several legislative changes:

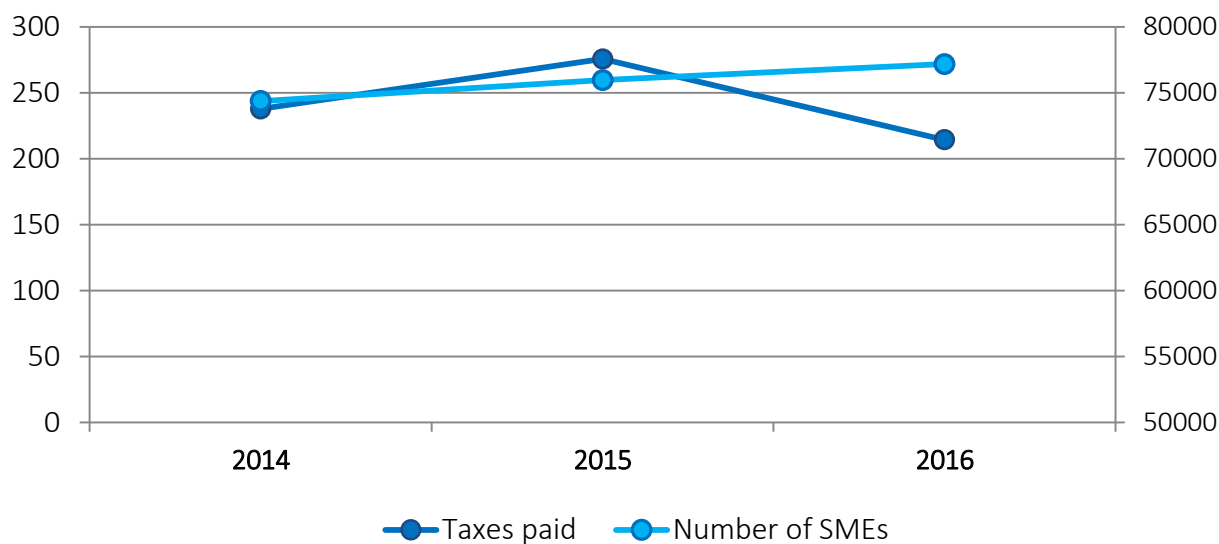
- Starting from July 1, 2015 turnover tax threshold was increased from 58.35 mln. AMD to 115 mln. AMD¹;

¹ Note: the threshold of 58.35 mln AMD will be in use starting from the year of 2019

- Starting from July 1, 2015 turnover tax rate for SMEs engaged in trade has changed from 5%. Taxpayers have gained an opportunity to reduce the rate to 1.5% level if presenting documentation on the costs related to the acquisition of the product.

These amendments have entailed change of the average turnover tax rate for trade companies to the level of **2.59%** according to the data provided by the RA State Revenue Committee (SRC). Moreover, following the SRC data we can state that trade area SMEs paid in total **8.2 bln AMD** in turnover taxes covering **52.9%** of the total turnover tax incomes received from the SMEs. Additionally, as opposed to the year of 2015, this number has increased by **34.4%**. All the above-mentioned provide evidence that opportunity to use deductions from turnover has reduced the overall tax burden.

Graph 11. Dynamics of taxes paid by the SMEs (left handside), in mln AMD and number of SMEs (right handside) in the years 2014-2016

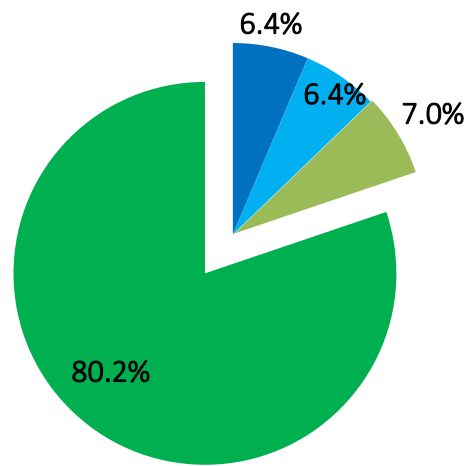
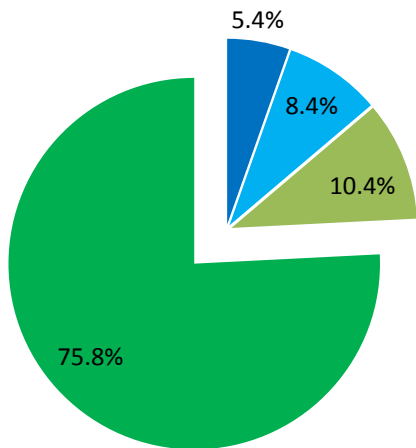


Nonetheless, the dynamics presented in the Graph 11 show that the taxes paid by the SMEs have reduced in 2016 by **22%** (or by **61.2 mln AMD**) in comparison with 2015 and amounted to **214.3 mln. AMD**, while the number of SMEs has steadily been growing since 2014 by **3%** on average. The latter inconsistency can be explained by the increase of the number of SMEs that enjoy full tax exemption or other tax privileges leading to lower overall tax payments coming from the SMEs.

Since 2014, number of SMEs has been increasing on average by 3%. In 2016, the tax payments by the SMEs have decreased by 22%.

Graph 12. SMEs in tax revenues, 2015

Graph 13. SMEs in tax revenues, 2016



■ Micro ■ Small ■ Medium ■ Other taxpayers ■ Micro ■ Small ■ Medium ■ Other taxpayers

Further closer look at the composition of the SMEs in tax revenues presented in Graph 15, 16 show that tax payments by SMEs in the total tax revenues have decreased, occupying now the share of **19.8%** as opposed to **24.2%** in the year of 2015. The tax payments decrease is mainly fueled by lower portion contributions from small and medium businesses as articulated in the graphs.

SUMMARY

Having conducted the needs analysis on SMEs operation, establishment and liquidation, the EBRD Business Support Office (BSO) experts in the past years have introduced several reforms schemes, including but not limited to the turnover tax introduction, laws on “state support to the IT sector” and “taxation privileges to self-employed people”, which have proven to improve the business environment for the SMEs in Armenia. The BSO team is planning to conduct similar researches on an annual basis, aiming to present actual and updated information related to the development of micro, small and medium-sizes enterprises to contribute to a more targeted policy relevant for the SME development in Armenia.

The current contribution reinstates the importance of the SME development and its definition as backbone of the Armenian economy. In the studied period, the SMEs accounted for **76%** of the Active taxpayer, provided an average of **33%** of country’s GDP and **64.3%** of its labor market, whereas the tax revenues coming from small and medium enterprises accounted for **19.8%** of total tax revenues.

We believe that the strategies and regulations developed by the state bodies, the concepts forwarded by public institutions, and the activities the latter imply, are necessary to be deemed and assessed from the viewpoint of SMEs in the first place, so as the proposed regulations do not impede the activities of SMEs and be centered around bettering their performance in the due time.

The EBRD Business Support Office staff hopes that this research will be useful for the structures operating in the field and conducting researches.