

Tax Policy for small and Medium Enterprises

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Abstract

Taxing small and medium enterprises (SME) is a significant issue in the globalizing economy. SME are also looking for expansion and Unions like USA and EU have real problems for finding the appropriate for of taxing multi state activities on one hand and easing the burden on other. The dimensions are different and the problems are different around the world. This paper is based on Bulgarian experience in taxing SME and some of the new changes on the European market due to expansion of the European Union. The paper will stress on the possibilities for presumptive type of taxation and home state taxation that are the most recent developments in getting these businesses in the tax net. The paper will examine the different types of taxes and the influence on the SME and will enlighten some of the ways to make satisfy both the revenue and the economic agents on the market.

Introduction

The legislation is a necessary regulator for protection of the business environment and security of the economic agents, for establishment of the necessary social security regulations but at the same time it hampers the business with additional expenditures and administrative obstacles, which place in different positions the SME. The big companies have more choices possibilities. They can either share part of the staff or hire people to deal only with studying the legal requirements and complying with the new regulations, or contract some personal service firm (like E&Y, Deloitte and Touché, Price Waterhouse etc) to deal with their tax compliance, planning etc. For SME this is a great expense out of their abilities.

"The government clearly understands that for the success of the reform the support of the small and medium size business in the country has a key role. The development of small and medium enterprises (SME) since they are the biggest employer and the biggest investor in Bulgaria will be inspired in every possible way." From the program of the Bulgarian government 2001 - 2005.

The problems, related with the increase of the compatibility of these enterprises are prior since the compatibility shows the capacity of the nations to acquire high productivity, based on innovative approach towards human resources, capital and physical assets. One of the contemporary regulative mechanisms is the tax policy and taxing the economic agents. Taxes are levied for regulating the investment behavior of the households and not for suffocating any entrepreneur initiative.

The goal of this paper is to make a parallel of the tax policy in a small country, like Bulgaria, that is going to enter the family of Europe soon and the general policy for the SME in big Unions, like USA and EU. The paper will show the different taxes levied in Bulgaria and their impact on the SME. Working in one country is sometimes burdensome for SME and working in global market is a nightmare. EU has achieved a very lower level of tax harmonization in the field of income taxation and this is problem for any expansion not only for SME but for a big corporations as well as they have to deal with 25 (27 after 2007 and more probably after that) tax regulations and tax administrations.

Almost in all developed market economies there is differential taxation for SME. In USA there is a variety of possibilities that would stimulate the business initiatives. But at the same time this causes loss in revenue as not all the SME are accurate in their accounting. Loss of revenue can be deliberately based on tax avoidance and even evasion or unwillingly due to lack of accounting competence of the business owners.

The European policy for SME is relatively young, starting 1983. The European Charter for Small Enterprises¹ recognizes SMEs as the backbone of EU economy and the key to implementing its Lisbon strategy of making Europe the most competitive and dynamic knowledge-based economy in the world. The importance of SME's is related to the philosophy for the changes in the emerging market economies. The small business is the key to the formation and expansion of a middle class and a civil society, which provide the main checks and balances against both backsliding in democratic reforms and clientelism.²

"In the past the EU's 23 million SMEs often only made it into the footnotes of political speeches. Now they are gaining the recognition they deserve as the backbone of the European economy, acknowledged as a constant source of ideas, innovation and entrepreneurial skills, the principal providers of existing jobs and the main source of new employment."³

In Bulgaria the taxing of SME does not differ from the rest taxation in the country, that means there are missing the so well known in the west preferences and relieves for the small and medium sized business. The differentiation has gone in the general strive for lowering the tax rates.

¹ The Charter was adopted in June 2000 and joined by candidate countries in April 2002. See http://europa.eu.int/comm/enterprise/enterprise_policy/charter/charter_en.pdf; for the text and http://europa.eu.int/comm/enterprise/enterprise_policy/charter/charter-2004_cc.htm for 2003 implementation reports by candidate countries.

² Clientelism denotes here forms of grand corruption, when democratic institutions are captured by powerful business groups and public policy serves the vested interests of this small clientele.

³ Think small first - http://ec.europa.eu/enterprise/smes/think_small_first_en.htm

Generally, policy choices comprise two groups of instruments. The first one pertains to the use of special tax preferences and incentives to support start-up and growth of small companies. These include lower corporate income tax rates, special tax exemptions and relieves for small businesses.⁴ The European Charter for Small Enterprises for instance, sets the objective that “Tax systems should be adapted to reward success, encourage start-ups, favour small business expansion and job creation, and facilitate the creation and the succession in small enterprises. Member States should apply best practice to taxation and to personal performance incentives.”

Corporation tax

In USA for example and some of the EU countries there are some easy forms of doing business – a pass through entities, check the box rule etc. while in Bulgaria the only possibility for a business entity from tax point is sole proprietor – as a pass through or patent tax and corporate taxed entity. Even there is a small portion of progressive rates from 15 to 18.33 % rates for SME with taxable income up to \$100,000.

The Law for corporate income taxation in Bulgaria does not treat different any more the different economic agents. After the last amendment, with which the rate was lowered from 15 to 10 per cent, all the firms become equal in front of the law. But this was not in favour to the SME. Since they have to fulfill all the legal requirements of that law and also to keep their bookkeeping. On the other hand almost all enterprises in Bulgaria fall in the range of small and medium enterprises according to the European standards. See Table 1

The registered as sole proprietors, which by all means does not mean that we have small or medium size enterprise are taxed during the year with advance payments if they are not on patent tax, according to the Law for corporate income tax and all of a sudden at the end of the year during the tax season, they form taxable income according to the Law of personal income taxation.

In the governmental program can be seen “Deleting the inconstancy of the legislation in the material tax laws and adjust them with the European legislation and creating at the same time conditions for economic growth.”

The revenues of the corporate income taxation in most of the EU countries are lower according to the international standards, as a percentage of GDP, despite the standard for the most of OECD countries rates for taxing the profit. The relative lower revenue and its diversification in the different countries with comparative near rates are based on couple of factors.

These relieves often include: investment tax credits, faster or accelerated depreciation for investment in equipment and in other assets (such as R&D), tax breaks for employment creation, and tax incentives for deprived areas.⁵ Investment tax credits in the EU member countries, combined with higher depreciation rates, favoured capital-intensive activities. Some of the countries have recently introduced or raised tax measures that favour small enterprises, newly created firms and/or information technology companies (e.g. France, Netherlands, Portugal, Spain, and the United Kingdom).⁶ These measures are designed to offset the disadvantages of new, or small, enterprises, helping them in financing their investment projects and the lower the tax compliance costs together with any other costs that might incur in their business.

In a number of cases, tax relieves are designed to attract investments. Countries have introduced special regimes to attract foreign direct investment. One of the first laws adopted in newly emerged market economies were those for protecting foreign investments. They bear clear message to the developed countries – we need you – your management and fresh money for preservation and reviving our sectors. In the framework of the European Union these preferences would be abolished and the only way to attract investments are the lowest corporate tax rates in the new member states, which has already brought up the dissatisfaction of the “old Europe”. In recent past both German Chancellor G. Schroeder and French President J. Chirak have requested relevant increase in the rates.

Patent tax (presumptive tax)

Presumptive (imputed) tax is replacement for standard personal or corporate income tax. It is implemented in cases when the tax base is too small or hard to verify or there are improper accounting practices. “The term presumptive taxation covers a number of procedures under which the ‘desired’ base for taxation (direct or indirect) is not itself measured, but is inferred from some simple indicators which are more easily measured than the base itself.”⁷

Presumptive taxes are among the oldest taxes. Earliest forms date back to the very origins of taxation when assets were the major source of income.⁸ Although income taxation was created back in 14th century by England still in the 17th and 18th centuries, taxes were based on measures of wealth more than income: size or value of land and other assets (in Germany and France), including number of doors and windows as an indicator of the value of residence (in the Netherlands).

⁴ Even though this is widely spread practice in many advanced countries, its rationale in terms of optimal tax theory is seriously challenged (see Holtz-Eakin, 1995).

⁵ The Baker and McKenzie (1999) survey singled out some of these specific sectoral and geographical tax regimes. They include: high unemployment regions in Belgium; the so called development zones and shipping in Finland; tax relieves granted by France for newly created companies in Corsica, the overseas departments and the so called “privileged investment zones” (of which Nord Pas de Calais); Eastern Lander in Germany; the less developed regions, and electric power plants and hotels in Greece; Dublin designated areas.

⁶ Freedman, J. and J. Ward (2000), “United Kingdom: Taxation of small and medium-sized enterprises”, European Taxation, International bureau of fiscal documentation, May. To help small companies, a 10 per cent starting rate was introduced in April 2000 for companies with taxable profits below £ 10 000. A 20 per cent rate is also applied for companies with taxable profits between £ 50 000 and £ 300 000 (the “normal” corporate income tax rate, i.e. paid by companies with profits above £ 1.5 million, is 30 per cent). In addition, the Budget 2000 introduced an enhanced relief for SME for R&D spending. From April 2000, SME are entitled to claim 150 per cent of their qualifying expenditure on R&D. In France, full and partial exemptions are granted to companies created between 1995 and 2004 if certain conditions concerning the type and location of the activity are satisfied.

Basic moment in the changes of the personal income taxes takes the change in the patent tax. Introduced under guidance from the World Bank in 1996 the patent tax was aimed to bring some revenue from otherwise always working at loss SMEs. The tax was proclaimed unconstitutional as according to the law the municipalities were given power to tax SMEs on their territories. But not this was its biggest disadvantage and unconstitutionally. It was not related with the income and ability to pay principle of the taxpayers. The new changes in it are chaotic and not systematically. The increase ranges are from 0 to 200 and even higher percent for the various activities. The presumptive tax has turned into money making machine of the government as the revenue is stable and easy to administer. For example the increase in the hotel business is from 50 to 150 per cent, in the catering from 50 to 122 per cent, in the whole trade from 300 to 500 per cent etc. which causes to forcing the medium and small producers in the grey economic sector.

Making equal the patent for some activities in Sofia hardly puts all taxpayers on equal basis. The jewellery shop in the outskirts suburbs does not have the turnover of that in the centre of the city but when talking about car service stations we have the opposite trend.

According to the Corlett-Hague Rule, every thing that is close to the free time activities has to be taxed higher because the free time it could not be taxed. But when talking about kids' free time activities, this is not all only about following the rules of the public finances. Anyway, all entertainment activities related to the free time of our kids were taxed over 50 percent higher. This brought some of the amusement parks which were built last couple of years to go bankrupt.

The drastic increase of the patent tax will on the one hand put a significant part of the economy's agents in the grey economy and will decrease the well-being of the population as a whole because the possibility of transferring these taxes to the consumers could be easily realized with the use of the goods' and services' prices.

Besides another statement in the program of the government is broken: "Achievement of equality of the tax agents, together with general decrease of tax burden in the field of the direct taxes."

Since all that pay patent tax are not exempt from all the taxes in the Law of corporate income tax, related with expenditures in the social sphere, promotional expenditures and automobile maintenance. These SME that pay patent tax have the same obligations and compliance with the tax legislation as all the other economic agents – keeping accounting records, making social and health insurances, purchasing control equipment "in the case, when the state defines its application with a decree" etc, but they do not have the opportunity to deduct all these expenditures like all the others big enterprises.

Value added tax (VAT)

The VAT legislation and the VAT itself are with the highest level of harmonization in the European Union. It is more harmonized and better organized than the sales tax in the different states of US. It is levied everywhere in the EU and is national type of tax contrary to the local and municipal character of the sales tax.

The impact of the established regime of value added tax (VAT) for the SME have to be seen from two sides. From one side the Bulgarian system of VAT have to join the implemented General system of VAT in the Common market. The objectives of this system are: to ensure equal treatment of common and national markets in terms of trade with goods and services, in order SME to operate free in the whole community from their head offices, without facing any additional administrative obstacles; to decrease misunderstandings and complexity in taxing with VAT and give the business General system for VAT, equally applicable and meeting the needs of a real common market; to decrease the misunderstanding based on different explanation of the rules. Bringing the Bulgarian system with the General system for VAT in the Common market will create the necessary stable tax media and will easy the Bulgarian SME in their foreign economic activity.

The existing regime of VAT in Bulgaria defines it as tax for the "big". SME are only bearing the burden of it.

Every business that has turnover less than 75 000 leva, cannot register for VAT and so has no obligation under the law, but also cannot use the right under this same law. These are small traders, handicraftsmen, persons delivering services etc. For them lowering of the registration barrier will be a big burden because this requires making such a change to be mad together with establishment of relieved regime for VAT for them. Since the decrease of the threshold is one of the trends in changing the Bulgarian Law for VAT in the harmonization process of our legislation with that of EU, creation of models for relieved regimes for taxing with VAT is crucial for us.

For other part of SME in Bulgaria the impossibility to register under the Law for VAT before their turnover for 12 month to become 75 000 leva is a problem, which hampers for the development of their business. These are mainly the product ional and newly created enterprises. For the product ional enterprises the problem arises mainly when the produced from them product is a part of the chain for production of goods for final consumption. In this case the enterprises buys equipment for production, materials and other assets for which by import or purchase in the country pays VAT, but does not have the right of tax credit and calculating VAT. If its clients are persons, who are not final consumers of the goods and they input it in further production and are registered under Law for VAT so it will be not suitable for them to work with this partner, since in the final price their goods will be increase with more VAT of 20 per cent and this increase in the price will make the good incompatible with similar production where all the agents are registered. Other not favorable impact is the impossibility to deduct paid from the enterprise tax by purchase of the equipment, raw materials and other assets. The foreseen in the Law for VAT mechanisms that neutralize this unfavorable impact are not for the greater part of the SME, which requires looking for other means for abolishment of the negative impact of the stated regime of VAT. Solution for this problem can be found by enlargement of the stated regime of voluntary registration. In the moment the voluntary registration is allowed for so called "big exporters" that have export at the level of 50 000 leva, for the persons that have total value of main assets of 150 000 leva and for those foreign legal persons whose real import capital is at least equal to one million US\$, despite of their taxable turnover or total export value. The existing regime gives advantages to the big firms for voluntary registration.

⁷ Ahmed and Stern (1991).

⁸ See Tanzi and Casanegra, (1987) on history.

The limitation for the possible voluntary registration is made basically to relieve the tax administration. The smaller number registered persons make easier the control on the good functioning of the mechanism of the tax and permits combination of the efforts of the administration on the bigger taxpayers that secure revenues for the budget. At the same time the position of the SME worsens.

These nonstop changes in the Law for VAT does not permit establishment of clear tax regime and put us away from the undertaken in the EU easing and improvement the administration and regulation business environment. The legislation of these countries in relation with value added taxation is very well developed and besides the general stability of the legal norms, foresees application also of numbers of relieved regimes of taxing. Prerequisite for that is also the developed legislation of these countries for the SME, definition of different groups and persons in the category of SME and creation of special regulation for them. In the different member - countries are applied different regimes for stimulation of some of the SME – relieved regime, simple method, deduction method etc.

Social security

The developed EU countries grant tax-favoured treatment to different saving vehicles. Typically, retirement schemes and housing investment benefit from these tax breaks. In both cases, these breaks are motivated in part by social or economic objectives: alleviating future pressures on public pension schemes and facilitating population access to proper housing. However, several empirical studies (OECD, 1994b) have shown that tax incentives are mainly reflected in the composition and not the level of saving. Tax breaks for retirement saving typically include the provision of tax allowances for contributions paid to pension funds or life insurance schemes and the absence of (or reduced) tax on income or capital gains earned by the funds. Many EU countries have recently increased (e.g. Italy, Spain), or envisage increasing (Germany), tax incentives to retirement saving, though from very different starting points. Adema (2000) estimates that tax breaks towards pension's savings amounted to more than two per cent of GDP in Ireland, the Netherlands and the United Kingdom, but to only 0.1 per cent in Germany in 1995.⁹

Tax breaks granted to owner-occupied housing are both widespread and extremely diverse. First, interest costs, and in some case principal repayments, are deductible from the tax base or give rights to a tax credit in 12 EU countries.¹⁰

With the amendments in the social security and retirement plans and expansion of the network for voluntary retirement plans in the material tax laws are given opportunities for deduction from the income considerable part for such plans. So as for the corporate income taxation this is limited to 480 leva per year for one employee on behalf of the employer and this under provision he is not on patent tax, from the worker's point of view he can deduct his whole income and avoid the taxation.

EU pilot scheme for SME¹¹

The basic concept and the fundamental objective of the Home State Taxation pilot scheme are very simple: to tackle the tax obstacles encountered by small and medium-sized enterprises when they operate in other EU Member States in addition to their own by granting them the possibility to apply the well-known corporate tax rules of their home state only. Thus a SME would be allowed to calculate the taxable profits for the parent company together with all its qualifying subsidiaries and permanent establishments in other participating Member States according to the tax base rules of its home state. The tax base so established would then be allocated to the Member States concerned in accordance with their respective share in the total payroll. Each Member State would subsequently apply its national tax rate.

The Key points of the scheme¹² are:

- **Basic approach:** Under the pilot scheme, SME active in more than one Member State can compute their taxable income (tax base) according to the rules of the system of the Home State of the parent company or head office only.
- **Tax rates:** Each participating Member State continues to tax at its own corporate tax rate its share of the profits of the group's business activities in that State.
- **Which SMEs:** Either small and medium-sized enterprises or, if need be from a Member states' perspective, only small enterprises in the official EU definition of SME can participate in the pilot scheme.
- **Who is part of the group:** The group of businesses included for the SME in the scheme is defined on the basis of the Home State rules.
- **Partnerships** are not included in the scope of the scheme unless the tax administrations concerned agree on a specific individual request.
- **Timeframe:** The pilot scheme runs for 5 years (e.g. 1 January 2007 – 31 December 2011).
- **Sectors of economy:** Specific sectors which are subject to separate tax rules are not included in the pilot scheme (e.g. shipping, agricultural activities, etc.)
- **Which taxes:** Taxes other than corporation taxes are in principle not included in the scope of the scheme. However, Member States could continue to apply national (profit-related) surcharges on the corporate tax or corporate tax base as established under the conditions in the pilot scheme

⁹ Adema, W. (2000), "Revisiting real social spending across countries: a brief note", *OECD Economic Studies*, No. 30, 2000/1.

¹⁰ Tax privileges on housing investment are easier to measure in countries, which have implemented a dual income tax. For instance in Denmark and Sweden, so extensive are the deductions of interest payments that the net revenues from the taxation of household capital income are actually negative. Acquisition costs are deductible (at least partly) in Austria, Belgium, and Portugal. In Spain, mortgage interest payments and acquisition costs give rise to a 15 per cent tax credit, with a maximum • 1 352 credit. Joumard, Isabelle. "Tax systems in European Union countries.", *OECD Economic Studies*, Wntr 2002 Issue.

¹¹ The material is based on the publications and issues of the European Commission and European Union from <http://ueapme.com>

¹² "TAXATION: HOW SMES CAN COMPUTE CORPORATION TAX ACCORDING TO HOME STATE TAX RULES.", *European Report*, Jan 11 2006 Issue

- **Which is the Home State:** The “Home State” of a participating SME-group is defined as the country of tax residence of the parent company (or headquarter), if need be with the help of the usually applicable tiebreaker rules.
- **Administrative rules:** The pilot scheme includes specific anti-avoidance rules and provisions for special cases (e.g. change of ownership; business expansion, business fluctuations etc.).
- **Tax assessment and payment:** Participating companies will self-assess report and pay the local tax but the calculation of the combined profits of the group will only need to be filed by the parent company in the Home State. The other tax administrations concerned receive copies.
- **Allocation formula for tax base:** The tax base as established on the basis of the Home State rules is apportioned on the basis of a simple formula (e.g. payroll) among the Member States concerned.
- **Third country income** of group members falls outside the scope of the scheme and is added to the income of the group member after apportionment.
- **Tax audits** would be carried out by the home state authorities, if need be jointly with the partner administration. The general rules for mutual assistance in the EU would apply.
- **Economic Impact Assessment:** The economic impact of the pilot scheme has to be assessed beforehand and interested parties are requested to provide the relevant data and information.
- **Legal framework:** The Commission would issue a recommendation on the basis of which Member States would prepare and conclude a bilateral or multilateral agreement. The Member States concerned would then implement the agreement domestically following their national laws and customs.
- **Monitoring:** Commission and Member States create a monitoring group for supervising the pilot scheme, considering possible practical problems and assessing its success.¹³

The fundamental approach of the pilot scheme is based on the idea of voluntary mutual recognition of tax rules concerning SMEs. It provides, in simple terms, that the profits of a group of companies active in more than one Member State should be computed according to the rules of one company tax system only, the system of the Home State of the parent company or head office of the group. Each participating Member State would continue to tax at its own corporate tax rate its share of the profits of the group’s business activities in that State. No harmonisation of rules is sought. The pilot’s objective is to address those tax problems that hamper SMEs most when expanding cross-border and often even prevent them from benefiting fully from the Internal Market’s potential. The following diagram illustrates the basic functioning of the scheme under consideration and defines the related technical terms as hereafter used in this document.

It is suggested that taxes other than corporation taxes not be included in the scope of the scheme (VAT; excise duties; wealth tax, inheritance tax, land tax, land transfer tax etc.). As regards local taxes, Member states would be allowed to continue applying national profit related surcharges on the corporate tax as established under the conditions of the pilot scheme (i.e. on that Member States’ share of the overall tax base). Other, non-profit related local or regional taxes could also be continued to be levied under the rules of the residence / Host state.

Participating companies would be obliged to file a tax return only in their home state. The responsible tax administrations of the other states concerned would receive copies of this tax declaration and the relevant annexes (e.g. balance sheets, profit/loss account etc.). There should not be any systematic requirement for translation but tax administrations could request that key documents are provided in the national language or another accessible language at the expense of the taxpayer. In many cases, these obligations could require a certain restructuring of any group in-house tax compliance functions.

The parent company will compute the combined profits of the group (under the rules of its residence ‘Home State’) and allocate those profits among the group members according to the pre-established formula. The figures of the various allocation criteria are reported to all Member States’ tax authorities. The payment of the tax will be made by the respective group unit in its residence (Host) State. The general rules for mutual assistance and administrative co-operation in the EU apply. In case of litigation it would in principle be the rules of the residence state of a Home State group member company that would apply. The Commission and participating Member States create a monitoring group for supervising the pilot scheme, considering possible practical problems and assessing its success.

Commission research on SME in the EU shows that only very small numbers of SME are currently active in Member States other than their own. The pilot scheme seeks to change this and help SME to participate in the opportunities of the Internal Market more easily by simplifying the relevant corporate tax rules and reducing the related compliance costs. The implementation of the pilot scheme would improve their business conditions and foster their survival rate and development possibilities via cross-border expansion in the Internal Market, thus generating beneficial growth and employment effects. The revenue consequences of the scheme for Member States would depend on its precise design, the number of participating SME and, not least, the details of the apportionment system chosen. Based on the statistical figures of SME which are internationally active and bearing in mind the very small proportion of corporate taxes paid by SME domestically, the amount of tax ‘at stake’ for Member States can safely be expected to be very low.

One of the main criticisms of Member State tax administrations of the proposed pilot scheme is the claim that the expected benefits arising from the scheme would not outweigh the administrative and other costs associated with its introduction. Furthermore, under internal Commission rules the expected impact of the scheme needs to be assessed before the actual initiative is launched (“extended impact assessment”). Therefore, it would in particular be desirable to establish a useful set of basic data for these works as soon as possible. The Commission services have started working on these questions and some data are available with publicly available statistics, including those published by the Commission Statistical Office itself. Most of the data are, however, if at all, only available at the level of Member States or with businesses. Business’ active collaboration on assessing the expected economic impact of the pilot scheme and provision of input into the necessary data

¹ *Outline of a possible experimental application of Home State Taxation to small and medium-sized enterprises*, Ref.: TAXUD C.1/DOC (04) 1410, Brussels, 24 June 2004

collection is therefore necessary. In a nutshell, the Commission services would need to know the extent to which the proposed pilot scheme would reduce the tax induced costs of setting up a subsidiary or permanent establishment in another Member State.

Conclusion

There is a need of constitutional change in order to give more tax independence of the municipalities in definition of patent tax or corporate income tax for them. This will help them in creating new tax regimes and use the taxes as real regulative mechanisms and not only for fiscal purposes. On the whole it is necessary to amend the Constitution, giving possibility for the municipalities to define the patent tax in certain limits, as the still existing corporate profit tax for the municipalities. From one side these taxes can be used as a regulator of the economic activity and from the other SME will be more closely related with the promises of the municipality in their election campaign.

The preference that can be provided in the Bulgarian tax legislation is on the example of the Netherlands not to pay VAT by acquiring of assets for usage in small and medium sized enterprise. The application of this preference in the Bulgarian Law for VAT can be only for part of the SME, dealing with production. For greater efficiency can be foreseen also incentives for part of the SME in some sectors of the economy but this requires serious and profound research of the economic sectors that need priority incentives. For this purpose can be used regional characteristics for definition of the enterprises that need that sort for stimulating by the indirect taxation.

In the area of the direct taxes it is necessary to form SME completely as legal person and abolition of sole proprietor firms with unlimited abilities because now they are taxed as under LCT and LPIT. It is necessary the patent taxes to be moved completely in the local authorities prerogatives, since they are in fact local taxes.

It is very important to form a way by which the SME can deduct from their profit the compulsory expenditures, which the state enforces by one way or another – insurances, social payments, cashier machine, control and measurement equipments etc.

It is of great importance enforcement of strong control in every sphere of activity of the SME – taxes, social payments, labour security and this should not be as a for of punishment operation for them but for their healthy growth.

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Table 1: Definition of SME in European Union 2003 - 2006

<i>Criteria</i>		<i>Micro enterprise</i>	<i>Small enterprise</i>	<i>Medium enterprise</i>
<i>Employees</i>		< 10	< 50	< 250
<i>Or</i>	<i>Annual turnover</i>	≤ € 2 million	≤ €10 millions	≤ €50 millions
	<i>Balance sheet total</i>	≤ €2 million	≤ €10 millions	≤ €43 millions

Source: http://ec.europa.eu/enterprise/smes/facts_figures_en.htm