

45TH SGATAR MEETING

TOPIC 1

IMPROVING THE COMPLIANCE OF SMALL AND MEDIUM ENTERPRISES

WORKING PAPER

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Improving the Compliance of Small and Medium Enterprises

1. INTRODUCTION TO SMALL AND MEDIUM ENTERPRISES

1.1 Definition of small and medium enterprises (hereinafter referred to as SMEs)

According to the Standards for Identifying Small and Medium-sized Enterprises promulgated by the Ministry of Economic Affairs, SMEs are business entities within the following scales:

A. Manufacturing, construction, mining or quarrying industry (either one):

(A) NT\$80 million paid-in capital or less

(B) Fewer than 200 regular employees

B. Other industries(either one):

(A) NT\$100 million annual sales revenue or less for the previous year

(B) Fewer than 100 regular employees

Nevertheless, in our taxation regime, the definition of SMEs is not easy to clarify. There is no accurate wording called SMEs in our tax laws; similar concepts, dubbed as Small-Scale Enterprises or Expanded Paper Review Cases through various laws, regulations, and administrative decrees, are meant to differentiate the average-sized enterprises instead. Here are two common thresholds:

A. Value-Added and Non Value-Added Business Tax (hereinafter referred to as Business Tax¹) Act:

¹ Consumption Tax is well-known as Business Tax in Chinese Taipei; Value-Added and Non Value-Added are two major stipulated ways to levy the Business Tax.

Enterprises with monthly sales no more than NT\$200,000 are deemed as Small-Scale Enterprises for Business Tax purposes, and for those with monthly sales no more than NT\$80,000 are exempt from the Business Tax. (Exceptions apply to certain businesses.)

B. Income Tax Act:

Enterprises whose annual revenue is no more than NT\$30 million can choose to file their tax returns by either regular returns or by statutory net profit margin returns (Expanded Paper Review Cases).

Therefore, for tax purposes, enterprises with annual sales lower than NT\$2.4 million (around US\$80,000) in our regime may be deemed as Small Enterprises; while enterprises with annual revenue of NT\$2.4 million but equal to or lower than NT\$30 million (around US\$1 million) may be recognized as Medium Enterprises.

1.2 Statistics for Cases in Taipei City

1.2.1 Year 2014 Business Tax report:

Enterprise Type	Registered Numbers*		Tax Revenue (NT\$ million)**	
	Count	Percentage	Amount	Percentage
Average	177,492	76.45%	39,563	73.34%
Small-Scale	40,062	17.26%	437	0.81%
Others***	14,612	6.29%	13,944	25.85%
Total	232,166	100.00%	53,944	100.00%

*: Registered as enterprises under operation on Dec. 31, 2014.

** : Accumulated number from Jan. 1, 2014 to Dec. 31, 2014.

***: Banking and special food and beverage services industries are included.

1.2.2 Year 2014 Income Tax report*:

Enterprise Type	Reported Cases		Tax Revenue (NT\$ million)	
Average** (Regular returns)	57,425	33.40%	69,784	97.57%
Annual Sales ≤ US\$1 Million (Regular returns)	50,525	29.38%	806	1.13%
Annual Sales ≤ US\$1 Million (Special treatment)	64,008	37.22%	932	1.30%
Total	171,958	100.00%	71,522	100.00%

*: Cases filed from Jan. 1, 2015 to July 31, 2015.

** : Public enterprises, Non-Governmental Organizations (NGO), and branch offices of foreign enterprises are included.

2. GENERAL CHALLENGES AND RELEVANT ADMINISTRATIVE MEASURES FOR MANAGING SMEs

2.1 General Challenges

2.1.1 Challenges for SMEs

In recent years, decreasing participation in manufacturing industries and a lower annual revenue growth rate compared to the Non-SME enterprises indicates that nowadays SMEs are facing more severe challenges and operating difficulties than big enterprises:

A. More competitive business environment:

Lacking the advantages of lower procurement prices and other input services access, it is difficult for SMEs to survive for a long time as evidence shows that in certain businesses there are no niches for SMEs. In addition, trends of increasing global trade and multi-national co-operation burden SMEs with higher costs to maintain their competitive operations. They are also vulnerable to possible losses due to insufficient overseas information.

B. More complicated tax environment:

Government agencies endeavoring to build a more equitable administrative system may inevitably increase compliance costs for SMEs, such as applications to International Financial Reports Standards (IFRSs), acquiring facilities for promoting Electronic Invoices, documentation for Anti-avoidance tax rules implementation, etc. These rules are the main factors to increase the complexity for sustaining basic tax administrative requirements.

C. Electronic-commerce (hereinafter referred to as E-commerce) environment:

Although electronic instruments and E-commerce-friendly payment procedures provide SMEs' customers more ways to enter transactions, such convenient phenomena can't persist without trained personnel and high-tech facilities. E-commerce services may create comparable burdens for SMEs to enter a new business or maintain their current business via these electronic means.

2.1.2 Challenges for tax authorities

A. Budget constraints and rising customer awareness:

In recent years, due to annual budget constraints and service quality enhancement programs, it has become difficult for tax authorities to fulfil higher and higher expectations from their taxpayers on a budget-decreasing basis. Meanwhile, tax authorities employees' service proficiencies are continuously decreasing as the complexity of tax administration increases.

B. E-commerce popularity:

The Internet is changing patterns of communication, so too patterns of business transactions. On-line shopping may make it easier for some SMEs to enter a business in the first place but difficult for tax authorities to detect the real panorama of SMEs' business. Relevant regulations and appropriate measures are big challenges for tax authorities under the time pressure.

C. Administrative Cost:

Allocations for auditing and service personnel and relevant resources between big enterprises and SMEs are not easy for tax authorities. In pursuit of cost-benefit maximization, SMEs are easily disregarded for their small contribution to the overall tax revenue. How to deploy the best resources to lower the cost for administering SMEs remains a challenge for every government agency.

2.2 Relevant Administrative Measures

2.2.1 Tax Policy

To reduce the compliance cost and improve the overall compliance for SMEs, special treatments for SMEs are conducted as follows:

A. Freedom from business registration and accounting requirements:

Small enterprises with monthly sales lower than the exemption standard (NT\$80,000, roughly US\$2,666, per month, exceptions apply to certain businesses) or self-employed family businesses are not required to submit business registrations to the local government (In Taipei City, the authority is Taipei City Government), nor are they required to keep accounting records or evidence in accordance with the Business Registration Act and Business Entity Accounting Act.

B. Freedom from Business Tax:

The regular Business Tax rate is 5% for total value added to the sales. Small-scale enterprises with monthly sales lower than NT\$80,000 (roughly US\$2,666, exceptions apply to certain businesses) are free from the Business Tax, while those with monthly sales lower than NT\$200,000 (roughly US\$6,666, exceptions apply to certain businesses) but equal to or higher than NT\$80,000 are subject to only 1% or 0.1% for the total sales in accordance with the Value-Added and Non Value-Added Business Tax Act.

C. Special law enacted in 2014:

"Act for Development of Small and Medium Enterprises" is meant to improve the business environment for SMEs. The relevant procedures are as follows:

(A) Five installment payments (conditions apply) or minimum tax rate for Land

Increment Value Tax (conditions apply)

(B) Income Tax Credit up to 15% for research expenses (conditions apply)

(C) Permission for declaring Investment Loss Reserve² as deductible expenses

(up to 20% of paid-in capital)

(D) Additional 30% deductible expense for the salary increased solely on the new recruitment in the relevant fiscal year

2.2.2 Targeted Assistance or Simplified Administration

2.2.2.1 Channels of assistance, outreach, education programs

Initiating regular mutual forums for SMEs to reflect on their business difficulties or offer practical advice, arranging Taxpayer-Friendly Visits periodically to hear SMEs' opinions, and holding conferences with Certified Public Accountants and Certified Public Bookkeepers to explain taxation policies directly to their SME customers. Implementing educational seminars and promotional programs annually for newly-released regulations and innovative services; creating new access to on-line media for public propaganda.

2.2.2.2 Simplified tax filing concessions

A. For Business Tax cases:

² Funds retained for possible future investment loss.

Small-Scale Enterprises are not required to file any tax returns and are subject to quarterly presumptive tax payments via an estimated sales assessed by revenue officers.

B. For income tax cases:

(A) For owners of the above Small-Scale Enterprises, relevant personal income earned through these enterprises will be calculated by the assessed sales at certain percentages and transferred to the owner's annual personal income list directly without the need to file any reports.

(B) Enterprises with annual revenue of no more than NT\$30 million (roughly US\$1 million) can choose to file their tax returns either by regular returns or by statutory net profit margin returns (Expanded Paper Review Cases). Regular returns adopt accrual accounting principles and are subject to records and evidence examinations anytime in five years. Statutory net profit margin returns, however, are eligible for using statutory net profit margin rates (ranging from 1% to 10% for different industries) to calculate their taxable income and are not subject to records and evidence examination (exceptions apply to certain businesses).

2.2.3 Tax Auditing

2.2.3.1 Ways of selecting tax auditing cases

For taxation efficiency and encouraging SMEs to prosper, it is necessary to maintain a relatively low auditing percentage for Small-Scale Enterprises unless reliable sources (such as mentioned in 2.2.3.3) occur. For income tax cases, define the proper selection range and percentage for SMEs and then utilize both manual and computerized selection methods at the same time to secure auditing accuracy.

2.2.3.2 Tax audit focus, frequency, and coverage

For SMEs, auditing is more focused on revenue than on cost or on expense. Unreported revenue, like on-line transactions or overseas deals, is undoubtedly the focus of SME auditing. As for Business Tax and Income Tax, while auditing frequencies are statutory once every half year and once a year, respectively, in practice, auditing frequencies are definitely longer. Tax auditing covers all kinds of industries, except for tax-free businesses.

2.2.3.3 Resources for tax auditing

An annual field check is one of the main sources for auditing business revenue. A revenue officer can have a better understanding of the real business conditions through practical examination.

Computerized cross-check data, like credit card sales, goods importation declarations, and data from different government agencies or private transaction platforms are other references for tax auditing.

Besides, due to the trends of customer awareness in recent years, many tax-evasion revelations or illegal-affair prosecutions have been provided by the public, the press, and even through other government agencies. These sources are urging tax authorities to conduct proper tax treatments toward these implicated SMEs.

3. SUPPORTING MEASURES, EVALUATION, AND CHALLENGES

3.1 Supporting measures

Construct a capable work force to execute the strategies and plans mentioned in 2.1 and 2.2 via internal employee training and up-grading computerized auditing systems. Implement more SME-friendly procedures, like new laws, taxation seminars, and free-of-charge consulting services to reduce SME taxpayer compliance costs.

Adjust the mandatory penalty for small-amount tax violation cases, which happens to SMEs frequently. Enact new laws and regulations for allowing SMEs a lower tax burden and higher profitability.

Sponsor social events and popular campaigns and encourage the public to be aware of fair taxation, hence creating a better taxation environment for SMEs.

3.2 Evaluation

A low tax rate and special treatments implemented in our tax regime are welcome by SME taxpayers for their considerably low compliance costs. However, such presumptive tax assessments turn out to be theoretically lacking in objectivity and against the principles of fair taxation.

Compared to most other countries in the world, big enterprises in Chinese Taipei are actually rare. Helping SMEs to grow bigger is our most important object for our nearly 90%-SME economy; focusing on bigger enterprises for tax revenues seems to be an economically sound way to support our tax administration.

3.3 Challenges

The above measures create the following challenges:

A. Unfair taxation and revenue loss

For certain industries, such as the entertainment business (singers, actors, program producers) and food & beverage business, it's easy to register as an SME and operate as a non-SME due to its hard-to-detect, cash-based revenue.

Manipulating big enterprises to elaborately divide their departments into several SMEs is heard of from time to time. These tricks merely use the system's flaws for a tax benefit, which increases the auditing complexities for tax authorities.

In accordance with scholars and reliable research, there are too many tax-free items and discriminatory tax treatments for SMEs in the tax regime. As a result, revenue losses may lure enterprises to stay as SMEs to enjoy the low rate on purpose.

B. Maintaining service quality with unstable personnel

Most SMEs which go to their tax authorities are mainly business starters or enterprises with low competitiveness. They may desperately need help from patient and experienced tax officers. Nevertheless, the high turnover and insufficient workforce of tax authorities make it difficult to maintain service quality for SME taxpayers. The tax authorities also suffer auditing difficulties from high training costs for their record-high new employees.

4. CONCLUSIONS

4.1 Good practice recommended

Promoting a lottery mechanism for our VAT system's uniform invoices encourages the public to obtain legal invoices, and SMEs which have good business but do not issue uniform invoices are easily targeted and revealed by the public, who ask the tax authorities to order these SMEs to issue uniform invoices, subjecting them to a higher tax rate.

In addition, we are promoting our Electronic Invoice System, whose transactions are uploaded to the cloud database. Such system is recommended for most industries and is mandatory for food industry, especially grease import or manufacturing business, for assuring transaction safety and public health. Once the network is completed, SMEs will no longer be a big problem to tax audit.

4.2 The way forward

Most big enterprises, creating most tax revenues, are forged from SMEs. Trees and saplings always need considerable care and nutrition. Unlike big enterprises, SMEs are more vulnerable to steep business competitiveness and are easily subject to substantial loss due to a lack of sufficient information.

For the people in Chinese Taipei, it's in their nature to be eager to be business starters on their own or operate a self-employing enterprise. To encourage these SMEs, it's necessary to set up relevant tax rules and regulations to help these future business giants to grow healthily.

On the other hand, what kinds of tax benefits and to what degree taxation authorities should offer is still a dilemma without immediate answers. Tax authorities should stay alert and keep concentrating on possible trends and making proper adjustments on their policies at the same time. "One loses by pride and gains by modesty" may also be applicable to SME taxation.