

Taxation of Micro Enterprises: Reduction in Compliance Costs

Consultation Paper

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An Roinn Airgeadais
Department of Finance



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1. Introduction

The Programme for Government for National Recovery 2011 – 2016¹, contains a commitment to:

“ direct the Revenue Commissioners to examine the feasibility of introducing – on a revenue neutral basis – a Single Business Tax for micro enterprises (with a turnover of less than €75,000 per annum) to replace all the existing taxes on sole traders and small businesses to cut compliance costs and make starting a business much less daunting”.

The first Annual Report² on progress in delivering the Programme for Government (March 2012) indicated that early analysis suggested that the measure could not be delivered in the form described but that work was ongoing in relation to the development of alternatives.

This consultation document highlights the issues which were identified in preliminary analysis carried out by the Revenue Commissioners on the feasibility of introducing a Single Business Tax (SBT). It describes some of the work carried out both nationally and internationally in reducing the administrative burden for small business. In light of the difficulties posed by a SBT, it examines the potential for achieving the objectives of the original proposal - *cutting compliance costs and making starting a business much less daunting* – by introducing a simplified accounting and profit calculation regime for micro businesses. Finally, it invites submissions on the issues around the introduction of such a regime.

2. Consultation

The Minister for Finance, Mr. Michael Noonan T.D., is inviting interested parties to make submissions on the issues identified in section 7 around the possibility of introducing a simplified accounting and profit calculation regime for micro businesses.

The consultation period will run to 28th February 2013. Any submissions received after this date cannot be considered.

How to Respond

The preferred means of response is by email to:
tmeconsultation@revenue.ie

¹ Programme for Government::

http://www.taoiseach.gov.ie/eng/Publications/Publications_Archive/Publications_2011/Programme_for_Government_2011.pdf

² Programme for Government Progress Report March 2012:

http://www.taoiseach.gov.ie/eng/Publications/Publications_Archive/Publications_2011/PfG_Progress_Report_March_2012.pdf

Alternatively, you may respond by post to:

Taxation of Micro Enterprises Consultation,
Income and Capital Taxes Division,
Revenue Commissioners
New Stamping Building,
Dublin Castle,
Dublin 2.

When responding, please indicate if you are a business, business professional, adviser, representative body or member of the public.

Freedom of Information

Responses to this consultation are subject to the provisions of the Freedom of Information Acts. Parties should also note that responses to the consultation may be published on the Department of Finance's [Tax Policy](#) website

3. The Micro Enterprise Sector in Ireland

SMEs make up a substantial proportion of the enterprise economy, with over 99% of businesses in this sector and almost 70% of people employed by them. Within the SME sector, over 90% of enterprises would qualify as micro enterprises, which are enterprises with less than 10 employees¹. Nationally, micro enterprises account for nearly 27% of employment.

As a largely indigenous, employment-intensive sector that relies primarily on domestic demand, SMEs are particularly responsive to changes in domestic policy. In view of the high proportion of people employed by SMEs in Ireland, they are especially relevant to addressing the country's unemployment concerns.

An analysis of tax returns for 2010 (the latest year for which figures are available) shows that approximately 174,000 unincorporated businesses and over 23,000 incorporated businesses had turnover of €75,000 or less. Respectively, these figures represent 76% of unincorporated businesses and 27% of incorporated businesses.

4. Administrative Burden on Business

The proposal in relation to cutting compliance costs and making starting a business much less daunting should be viewed in the broader context of Government objectives to reduce the administrative burden for business arising from domestic regulation. In the area of taxation, for the sixth year running, Ireland continues to be ranked the easiest country in the EU in which to pay business taxes, and in 2012 was ranked the

¹ European Commission Recommendation [2003/361/EC](#) of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises

sixth easiest in the world out of 185 countries to pay such taxes according to an annual index by the World Bank².

In terms of “ease of starting a business”, the latest World Bank report records Ireland as improving its ranking among the 185 countries from 13th to 10th place, which is the highest ranking of any EU Member State. By way of comparison, the UK is ranked 19th, France 27th, Finland 49th and Germany 106th.

Significant work carried out by the Revenue Commissioners since 2008¹ shows that the administrative burden on business generally has been reduced by 25%, saving businesses over €85 million annually.

The main initiatives, which led to the 25% burden reduction, were:

- Reduced filing frequencies for VAT, Employers' PAYE/PRSI and Relevant Contracts Tax;
- An increase in the VAT registration threshold;
- Pre-population of income tax and corporation tax forms;
- A new electronic Relevant Contracts Tax (RCT) system;
- Ongoing expansion and improvement to the range of electronic services on the Revenue Online Service (ROS).

Recognising that the compliance burden on businesses can be exacerbated by complex legislation and regulation, the Revenue Commissioners have also undertaken an extensive programme to systematically consolidate and streamline older tax and customs legislation including stamp duty, capital acquisitions tax and VAT legislation.

A number of surveys have been carried out in the last decade to get the views of business in relation to administrative burden associated with regulation/compliance.

The ESRI carried out a comprehensive survey² of Irish businesses in 2006 to find out their views of regulation and which areas of regulation posed problems in terms of compliance costs, including administrative burdens. The three areas which were considered to have the most direct impact on businesses were identified as VAT (42%), income and corporation tax (37%) and health and safety regulations (32%). In micro enterprises (employing less than 10 employees), over 33% of businesses identified VAT as the particular area of regulation having the most impact, with nearly 25% identifying Income and Corporation Tax.

The Revenue Commissioners carried out a survey of small and medium sized business customers in 2008. One of the areas covered was in relation to administrative burden. Those surveyed were offered the opportunity to state what aspects associated with Revenue-related matters they found most burdensome and why. It was found that most of the issues arose in relation to paperwork and VAT returns.

² World Bank “Ease of Doing Business Index”

¹ Administrative Burden Reduction Report: published July 2012

² Business Regulation Survey; Department of the Taoiseach, March 2007

In the light of these findings, a number of simplification measures have been introduced in recent years in the VAT area in order to reduce the compliance burden for business. In addition to the measures outlined in the Administrative Burden Reduction report (referred to above) in relation to less frequent filing and e-filing, initiatives have been taken in the area of cash accounting which is also known as cash receipts basis or moneys received basis. It allows a taxable person to account for VAT when payment is received instead of when the invoice is raised. Ireland now has optional cash receipts basis for:

- VAT-registered traders whose supplies of goods or services are almost exclusively (at least 90%) made to unregistered persons. This would apply in practice mainly to retail outlets, public houses, restaurants, hairdressers and similar types of business,
- VAT-registered traders whose annual turnover (exclusive of VAT) does not exceed or is not likely to exceed €1,000,000 (threshold effective from 1st March 2007). This will increase to €1,250,000 with effect from 1st March 2013.

5. Single Business Tax

In examining the feasibility of introducing a SBT, a key issue is the extent to which different taxes could be incorporated within a SBT, as this would influence the extent to which the burden on small business can be reduced.

EU rules mean that VAT could not be accommodated within a SBT. As a consequence, any proposal for a SBT would have to apply below the VAT thresholds.

In addition, it is considered that it would not be realistic to include in a SBT the fiduciary obligations on employers in respect of Income Tax (PAYE), PRSI and USC due by their employees. This is because these amounts are not a part of business income, turnover or profits and they would clearly and naturally sit outside of a SBT.

Personal income tax, PRSI and personal USC of a business owner could be considered for inclusion in a SBT. Capital Gains Tax could also be considered but only insofar as the gain arises in respect of assets used in the business.

A further issue is the interaction between a SBT on trading income and income tax on other income including income of a spouse or civil partner where a couple are jointly assessed.

Taking all of the foregoing considerations into account, it would seem that the need to exclude VAT and employee deductions from the scope of a SBT means that the proposal is unlikely to benefit micro enterprises in an appreciable way.

6. International Context

A number of jurisdictions have recognised the need to ensure that complex tax obligations do not discourage business start-ups. The general response has not been a SBT, possibly as a result of the issues identified in Section 5. Instead the general approach has been to introduce simplified regimes aimed, inter alia, at simplifying

accounts, record keeping and the calculation of profits. A brief description of some of these regimes is given in the **Appendix 1**.

In the UK, the Office of Tax Simplification (OTS) has been examining relevant issues in the UK tax system. The OTS published a report in February 2012¹, which concentrated on the very smallest unincorporated businesses. The key points in the report are:

- Current accounting requirements can be disproportionately burdensome on small businesses especially considering the small amounts involved.
- Small unincorporated businesses should have the option to calculate their taxable income on a simple cash receipts and payments basis.
- The best approach would be to use receipts and payments accounts as the default for small businesses but to allow opting out where desired, with limited ability to move between the two bases. Existing businesses which are currently calculating profit using Generally Accepted Accounting Principles (GAAP) should be able to continue to do so.
- A turnover-based tax (which would be akin to a SBT) should be investigated further.

In response to the OTS recommendations, HMRC announced in March 2012 that it would introduce a new cash basis for calculating income tax for small unincorporated businesses from April 2013. It issued a consultation document on this matter in March 2012 and the results of this consultation process are due to be announced shortly. The key features of the consultation document are set out in **Appendix 2**.

After carefully considering the various issues around the OTS suggestion that a turnover-based tax should be investigated further, the UK Government decided not to take this suggestion forward.

7. Simplification for Micro Businesses in Ireland.

In the light of the difficulties posed by a SBT and which are outlined in Section 5, it is considered that a better approach to meeting the objectives set out in the Programme for Government might be to explore the possibility of a simplified accounting and profit calculation regime for micro businesses.

7.1 How would a simplified regime work?

Currently, the Taxes Consolidation Act 1997 (section 91) provides that the “earnings basis” is the strict legal basis for drawing up accounts for tax purposes. All companies are required to prepare accounts on this basis, as are individuals and partnerships carrying on trades. Only in limited cases has the Revenue Commissioners accepted accounts prepared on a basis other than the “earnings basis” e.g. some professions and certain farmers. While a move to a simplified accounting and profit calculation regime for micro businesses would represent a departure from

¹ Office of Tax Simplification - Small Business Tax Review – Final Report – Simpler Income tax for the smallest businesses – February 2012

the current position, it would hold out the possibility of reducing the administrative burden on such businesses.

In essence, micro businesses would be given the option of calculating their taxable income on a simple cash receipts and payments basis. Businesses, which wish to calculate profit using GAAP, would be allowed to do so.

In view of the requirements of the Companies Act in terms of filing annual returns and accounts with the Companies Registration Office (CRO), it is considered that it would not be appropriate to include companies within a simplified regime, as it would be of little benefit to companies.

Apart from the use of a receipts and payments basis for calculating income, consideration could also be given to a simplified expense deduction regime for those expenses which require significant record keeping or calculations under current rules. For example, business motor expenses could be calculated using a standard mileage rate, which would mean that the only record needed would be a record of business mileage. This rate could include an allowance to cover the cost of depreciation and other expenses associated with running a car for business purposes. Similarly, standard deductions could be used for the use of a private residence for business purposes, obviating the need to keep records of costs such as light and heat and to make apportionments.

Wear and tear allowances are provided for in the Tax Acts in respect of capital expenditure on plant and machinery used for the purposes of a trade. The rates at which allowances apply have narrowed over the years but in general now apply for an eight year period (apart from cars where a 20% reducing balance applies). Consideration could be given to allowing for the writing off of the cost of small items of expenditure in the year of purchase or the year in which expenditure is incurred. Small items could include computer equipment, office furniture, etc. with an overall threshold applying. It would not be appropriate to include a business car, as the cost of a car is unlikely to come within a threshold for small capital items.

7.2 What threshold would be appropriate and what flexibility would be desirable around the margins?

The Programme for Government refers to micro enterprises with a turnover of less than €75,000 per annum. As 76% of unincorporated businesses would come within this threshold, it is clear that adoption of such a threshold would include a very high proportion of micro enterprises.

For a number of reasons, some flexibility would be needed around applying a threshold. Businesses, which are marginally below the threshold, may end up with a competitive advantage over businesses that are marginally above the threshold. This could result in businesses moving some of their income into “a trade within a trade”, thus becoming part of the shadow economy or alternatively cases may suppress growth in their business if they feel that by growing the business they end up with a higher administrative burden.

7.3 Should micro business be given the choice of opting in or out of a simplified regime?

If a choice is given in terms of opting in or out of a simplified regime, there may be implications for Exchequer revenues. This is an important consideration having regard to the requirement in the Programme for Government that any measure should be revenue neutral.

If businesses were allowed to opt in/out, consideration would need to be given to how often a business would be allowed to move between a simplified regime and the mainstream tax system. There could be costs for both business and the Revenue Commissioners in allowing switching between regimes, aside from any implications for Exchequer revenues. One possibility is to have the new regime as the default for small businesses but to allow opting out where desired, with limited ability to move between the two bases, with changes only being allowed, say, every 5 years. Alternatively, the new regime could be allowed as the default with a once-off election to the normal system. If a business is satisfied to switch from a simplified regime and to operate under the current rules, there would appear to be little justification for allowing it to switch back again. Regardless of the approach taken, a transitional adjustment might be needed to ensure that, in a change of base, profits do not escape tax. Existing businesses which are currently calculating profit under the old system should be able to continue to do so.

7.4 What transitional arrangements would be needed?

Regardless of whether an opt in/out option is made available, businesses within a simplified regime will, over time, outgrow the parameters governing the regime. The question then arises as to what rules should be put in place to ensure a smooth transition for a business from a simplified regime to the mainstream tax system.

7.5 How can revenue neutrality be achieved?

The Programme for Government requires that any measure should be revenue neutral. A number of considerations arise. Firstly, the precise nature and features of the regime will influence the extent to which revenue may be affected. Issues around opt in/opt out are dealt with at Section 7.3 above. The extent of any transitional adjustment designed to ensure that, in a change of base, profits do not escape tax will also be a factor. There will inevitably be some loss of revenue in moving from an earnings or accrual basis to a cash receipts and payments basis. Further work on this issue will be required following the consultation period.

7.6 Change Management

A key fundamental in rolling out a simplified regime would be a robust change management process, which would include consultation with key stakeholders. These would include representative bodies such as ISME and the SFA, ICTU, accountancy bodies, tax practitioners and accounting software companies.

8. Summary/Call for Submissions

The initial exploratory work around the feasibility of introducing a SBT raised some fundamental questions around the extent to which introduction of a SBT would, in fact, achieve the objectives of cutting compliance costs on small business and making starting a business much less daunting. It is considered that a better approach to

meeting the objectives set out in the Programme for Government might be to explore the possibility of a simplified accounting and profit calculation regime for micro businesses.

Surveys to date of the SME sector have not focussed explicitly on micro enterprises with a turnover of less than €75,000 per annum. This consultation process specifically targets that group.

Interested parties are invited to make submissions on the benefits or otherwise of introducing a simplified accounting and profit calculation regime for micro businesses. Submissions should in particular focus on the issues covered in Section 7 of this paper. However, comments on other aspects of paper are also welcome. In keeping with the Government's objective of reducing the administrative burden for business, interested parties are also invited to make submissions on any additional simplification measures, which might usefully be undertaken in the area of taxation, which would seek to reduce the administrative burden for small businesses.

Appendix 1

Simplified Measures for SME's in other OECD Countries

France

A number of initiatives to promote enterprise and employment in the small business sector have been introduced. A “micro-enterprise” regime was introduced for sole traders in 1999 whereby profit is determined by applying a flat rate deduction to turnover to give a notional “profit” amount and then the normal taxable bands for income tax are applied to this profit. Because of EU VAT constraints, this regime is confined to individuals who are not registered for VAT or do not elect to register for VAT.

The Auto-entrepreneur regime was introduced in early 2009 as a new start-up mechanism. Under this regime, registration, accounting and capital requirement obligations were relaxed and tax and social security charges were streamlined. Under the “auto-entrepreneur” regime, income tax is calculated as a percentage of turnover in the business, with different rates applying to different sectors. Payment under this regime represents a combined payment of income tax and social contributions.

Australia

There are a number of income tax concessions for certain eligible business with a turnover of less than approx €1.5m

Simplified trading stock rules: Businesses can choose not to do an end-of-year stock take and account for changes in the value of trading stock, if the value of their trading stock has not increased or decreased by more than \$5,000 (€1,017) over the year.

Simplified depreciation rules: Assets can be pooled to make depreciation calculations easier and also claim an immediate deduction for most assets costing less than \$1,000 (€303) each.

Immediate deductions for prepaid expenses: An immediate deduction for prepaid expenses can be claimed where the payment covers a period of 12 months or less that ends in the next income year.

Germany – Income-expense calculation

Self-employed persons and small enterprises with an annual turnover below €500,000 and/or an annual profit of less than €50,000 are entitled to use a simplified income-expense calculation to determine their taxable profit. Apart from exempting businesses from the duty to keep complete tax accounts the system ensures that revenues are only taxed when they materialise. For investment expenditure, special rules apply.

Belgium – Simplified calculation of profits

The Belgian tax code provides for the profit of a small enterprise to be estimated on the basis of similar enterprises in the same sector. Small businesses are thus not required to keep records of their sales and expenses. This process requires prior consultation with the professional associations and the Belgian tax administration has

concluded collective agreements with numerous sectors (e.g. bakeries, groceries, butchers, pharmacists, bars, hairdressers). Profit estimation is based on simple indicators that provide a sector specific relationship between profit and economic activity. The system is applied on a voluntary basis; enterprises can opt for determination of their actual profits if this is more beneficial for them. On the other hand, if the tax administration can show that the real profit is considerably higher than the result of the lump-sum calculation, it can tax the actual profit.

The Czech Republic – Lump-sum deductions and estimated tax liability

Small businesses may opt for a lump-sum deduction of expenses in order to determine their taxable income. The lump sum equals 50% of gross income (for some trades such as agriculture the lump sum is even 80%). Taxpayers opting for lump-sum deduction are not obliged to keep specific records of their expenses. Taxpayers deriving income from a business or farm may request an estimated assessment at the beginning of the taxable period, once certain conditions are met. The request must include the expected income and expenses, along with other relevant facts. The estimated tax is the final tax for the taxable period. The scheme generally applies to individuals and not to companies.

Chile – Simplified Accounting System

The Simplified Accounting System started in March 2007, as an alternative regime, available to all taxpayers who meet the requirements. The regime is not compulsory. It is applicable to individual enterprises, not including corporations, with sales less than US\$180,000 per annum. The system is based on a cash system. Taxpayers only have to register their incomings and outgoings. Investment and stock payments can be deducted immediately.

Appendix 2

HMRC Consultation Document Simpler Income Tax for the Simplest Small Business March 2012

Key Proposals

- The proposals are that small business will be taxed on the basis of the cash that passes through their books, rather than being asked to spend their time doing calculations designed for big business. This is called a voluntary simplified cash basis (later referred to as 'cash basis'). The system will work on a cash in, cash out basis. For income, it's what you receive when you receive it; for outgoings, it's what you pay when you pay it.
- Claiming expenses will be a lot less complicated. Where you can't easily distinguish a business expense from a personal one, simplified expenses will help. For instance, someone working from home will be able to apply a flat-rate deduction for using, say, their household gas or electricity rather than having to make individual adjustments when claiming their expenses.
- The cash basis and simplified expenses will be used to calculate taxable income.

The following types of businesses are excluded from the proposals

- Businesses subject to Corporation Tax (e.g. companies).
- Limited Liability Partnerships and any other partnerships not specifically included within the scope.
- A business that is registered for VAT but is not using the VAT Cash Accounting Scheme.
- Businesses, e.g. farmers or authors, that have a current averaging claim under Chapter 16 ITTOIA 2005.
- Traders such as farmers who have a current herd basis election or make such an election.
- Financial trading businesses.
- An individual who is a member of Lloyds and who is carrying on underwriting business as defined by S184(1) FA1993.

Before using the cash basis for the first time, an existing small business will need to bring its period of account for the purposes of applying the normal tax rules to an end on 5 April. This will be the final period of account using the normal rules. When a small business switches to the cash basis it may need to make some adjustments to taxable income. These would be made in the first tax year of the cash basis and are necessary to ensure that receipts are taxed once and only once and expenses allowed once and only once. Similar provisions would apply to businesses leaving this system.